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Current Developments in

# THE FARM REAL ESTATE MARKET

July - November 1959

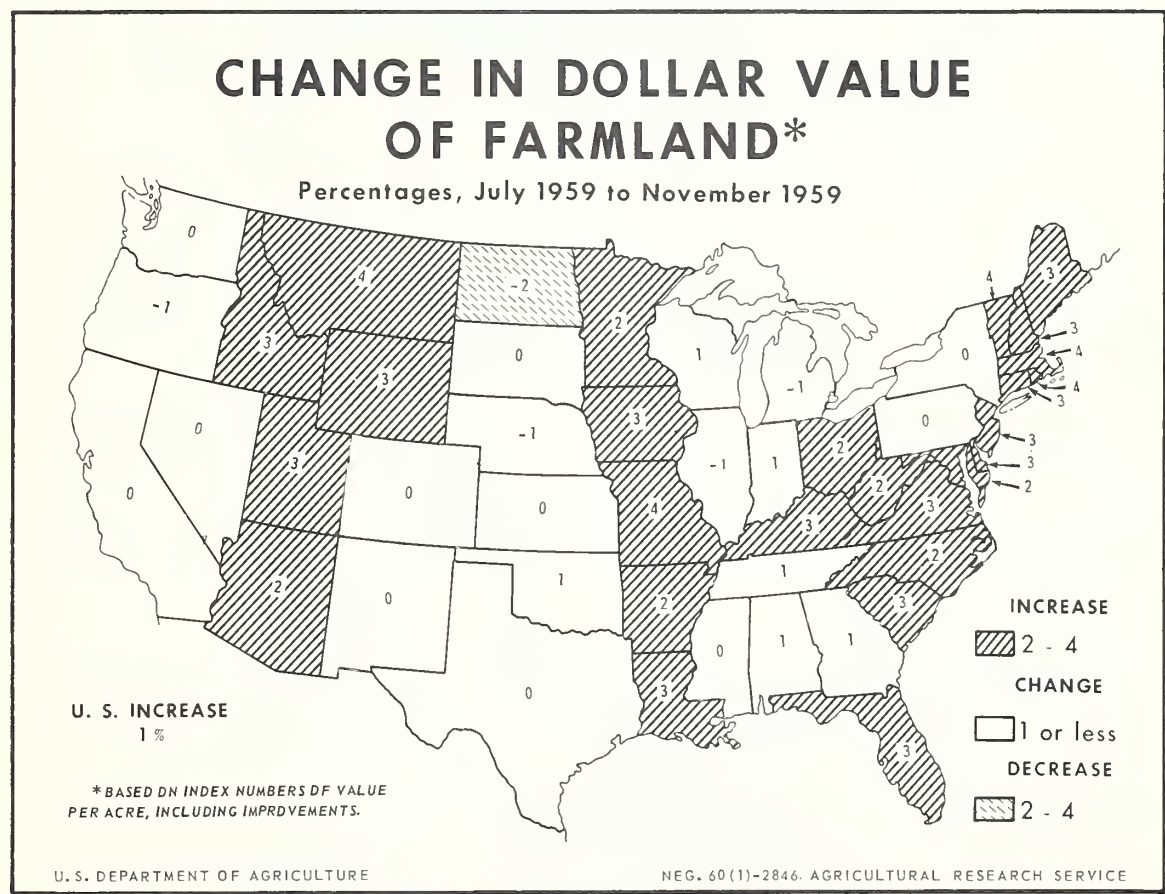
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In This Issue:

- Returns to Productive Capital in Agriculture
- Tax Aspects of Transferring Ownership of Farm Real Estate
- Index Numbers of Farm Real Estate Values, by States, 1912-59



In the 4 months ended November 1, 1959, market values of farm real estate remained essentially unchanged in about half the States. These States were chiefly in the eastern Corn Belt, the central South, and the Great Plains. Elsewhere, increases of 2 to 4 percent were typical. The national index advanced to 171 (1947-49 = 100), only 1 percent above July 1, but 5 percent above a year earlier.

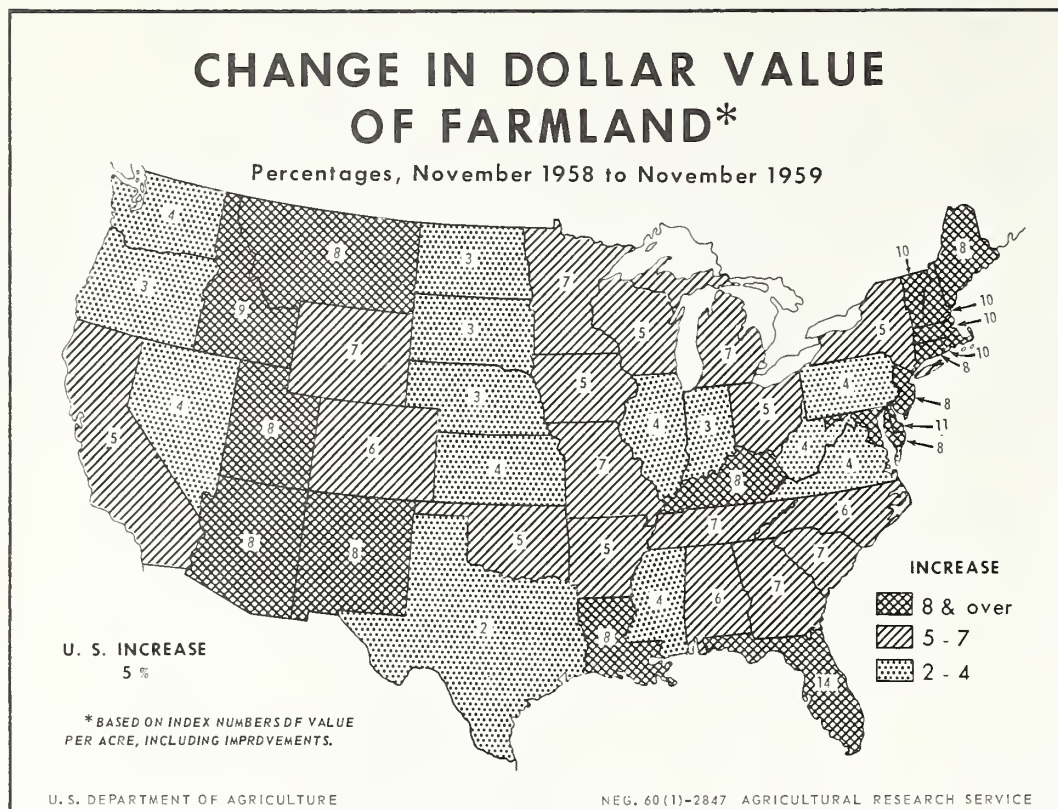


Figure 1

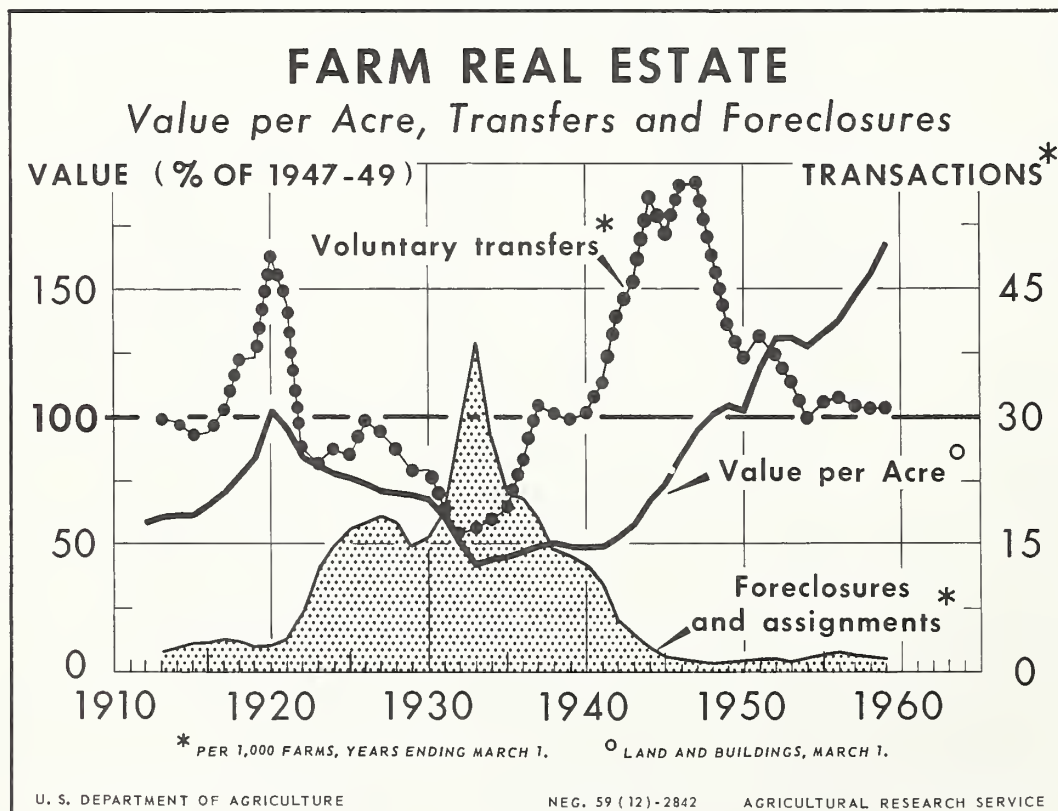


Figure 2

## CURRENT DEVELOPMENTS IN THE FARM REAL ESTATE MARKET

July - November 1959

Approved by the Outlook and Situation Board, January 15, 1960

### SUMMARY

The slower rate of increase in market values of farm real estate, first apparent in the March to July 1959 period, continued in the 4 months ended November 1. The national index for the latest date was 171 (1947-49=100), only 1 percent above that of last July but 5 percent above the index a year earlier. As of November 1, the total dollar value of farm real estate was estimated at \$127.8 billion, or about \$110.50 per acre; this was 2 percent higher than in March.

No significant change in values between July 1 and November 1 was reported in about half the States. Most of these States were in the eastern Corn Belt, the central South, and the Great Plains. The remaining States showed increases of 2 to 4 percent and were concentrated chiefly in New England, and in several other States that contain the large east-coast centers of population. Values in Florida, and in a tier of States extending from Minnesota to Louisiana continued to advance. Values in several Mountain States were up also.

The volume of sales in the summer and early fall of 1959 did not change much nationally from a year earlier, but several regional differences were apparent. Sales volume appeared to be lower in the spring wheat and western Corn Belt areas, partly because of drought. It was slightly higher in the Northeast, northwestern wheat, and general farming areas. Foreclosures remained within the low range of 1.0 to 2.3 farms per 1,000 that has prevailed since 1945.

Farm real estate dealers reported fewer listings of farms for sale last October than a year earlier. However, the consensus of nondealers was that slightly more farms were on the market. Strongest indications of an increase in offerings were found in the eastern Corn Belt and spring wheat areas.

Both dealer and nondealer reporters agreed that fewer people were looking for farmland last summer and early fall than a year earlier. More recent indications are that since last fall demand has slackened further. Dealer's inquiries continued to come chiefly from farmers already owning land and from nonfarmers. Within the latter group, investors accounted for 23 percent of dealers' total inquiries nationally, but the proportion ranged to more than a third in areas where nonfarm influences are most prevalent.

Financing of farm transfers last fall was said to be generally more difficult than a year earlier. Although interest rates were a little higher for most lenders last October, the increase shown in central money markets had not yet been fully reflected in the rates for farm mortgages. Several



lenders reported a sharp decline in their loan commitments in the fourth quarter of 1959 compared with a year earlier.

Present levels of interest rates are likely to cause increasing downward pressures on market values of land for farming purposes. With the decline in net income in 1959, and the prospect for some further decline in 1960, investment demand for land may weaken because more attractive rates of return are possible from alternative investments. The desire to shift capital from land into higher yielding investments could lead to more farm offerings. However, taxes payable on capital gains will tend to restrain such decisions. Prospective buyers wanting land to farm may be less responsive to higher interest rates than investors, but there is some evidence that they are more hesitant to make long-term mortgage or contract commitments at present interest rates.

The market value of assets used in farm production reached a record high of \$152 billion in 1959. The rate of return on the value of proprietors' equities (operators and landlords combined) totaling \$131 billion was estimated at 3.2 percent, the lowest rate in the 1940-59 period. Farmland and service buildings represented 75 percent of total productive assets, and if all other factors had been paid for at their market cost rates, they would have received a return of 3.0 percent. The rate of return on the original cost would be substantially higher.

#### THE FARM REAL ESTATE MARKET IN THE FALL OF 1959

Market trends and developments in 1959 were largely a continuation of those that had prevailed since 1954. In most of this period, demand for land was strong and offerings were limited. Prices advanced 6 to 8 percent a year without corresponding changes in farm income. The major exception was 1958, when income increased more than land values. The effects of the favorable 1958 income carried over into early 1959 and gave support to the land market through midyear. Credit with which to finance land purchases was generally adequate throughout the 5-year period, and interest rates changed within fairly narrow limits.

The decline in farm income in 1959, prospects of some further dip in 1960, and developments in the credit market are the major factors likely to affect the land market in 1960. As of last November, these factors had resulted in only a moderate slowdown in the rate of increase in market values.

#### Values Rise 1 Percent From July

The U. S. average value of farm real estate per acre increased 1 percent in the 4 months ended November 1, 1959. This followed an increase of the same size in the March to July 1959 period, a rate of increase that was less than in periods of similar length for the last 3 years. This is the first time since mid-1956 that values have risen only 1 percent in 2 consecutive periods (table 1).

Table 1.- Percentage change in index of average value of farm real estate per acre, by farm production regions, selected periods, 1957-59

Region	Change during year ending November			Change during 4 months ending November		
	1957	1958	1959	1957	1958	1959
	Percent	Percent	Percent	Percent	Percent	Percent
Northeast-----	8	6	6	1	2	1
Corn Belt-----	6	5	5	1	2	1
Lake States-----	8	5	6	1	1	1
Appalachian-----	7	6	7	2	2	3
Southeast-----	11	10	9	2	3	2
Delta States-----	8	6	6	2	2	2
Southern Plains----	8	5	3	4	3	0
Northern Plains----	7	8	3	2	1	-1
Mountain-----	6	5	7	2	2	2
Pacific-----	7	3	4	1	2	-1
United States--	8	6	5	2	3	1

The November 1, 1959, national index of average value per acre was 171 (1947-49=100). Values remained essentially unchanged from the July 1 level in about half the States. These States were in five groups scattered across the country. One group consisted of New York and Pennsylvania. A second included the States bordering Lake Michigan -- Indiana, Illinois, Michigan and Wisconsin. Four Southern States - Tennessee, Georgia, Alabama and Mississippi - formed a third group, while the westernmost was made up of the Pacific States plus Nevada. The largest group of States in which values remained essentially unchanged from July included Colorado, New Mexico, and all of the Plains States except North Dakota. Values in North Dakota declined 2 percent. This is the first time that values in any State have declined by this amount since November 1956. In the remaining 26 States, values increased 2 to 4 percent.

#### Increase in 1959 a little less than in 1958

In the 12 months ended November 1, 1959, the U. S. average value of farmland and buildings increased 5 percent. In the preceding 12 months, values rose by 6 percent. The smallest increase in 1959, 2 percent, was recorded for Texas. The Northern Plains States, as well as Washington, Oregon and Nevada, two Corn Belt States (Illinois and Indiana), New York, Virginia and West Virginia, and one Southern State (Mississippi) had relatively small increases of 3 or 4 percent (fig 1.). In 17 additional States, values were 5 to 7 percent higher on November 1, 1959, than they were a year earlier.

Increases in excess of 7 percent were recorded for all New England States and for 11 other States. The largest, 14 percent, was in Florida, followed by Delaware, with an 11-percent boost.

### Reporters' Opinions of Current Levels of Market Prices

Nondealer reporters in the October 1959 survey of the farm real estate market were asked to express their opinions concerning the current level of farmland values. <sup>1/</sup> They were asked to indicate whether they thought land values in their localities were too high, about right, or too low in relation to current levels of net farm income. Nearly half the respondents were of the opinion that land values were too high in relation to income (table 2). Less than 10 percent believed land values were too low; the rest, about two-fifths, looked on land values as being about right in relation to income.

The low frequency of opinions that values were too low was common in all areas. However, the balance of the "too high" and "about right" opinions varied between areas. The proportion believing values to be too high was considerably less than the national average in the Northeast, Lake States cut-over, spring wheat, and central cotton areas; the proportion stating that values were about right was correspondingly higher than the national consensus. Conversely, the proportion of reporters feeling that land was overpriced in relation to its current earning capacity was considerably larger than the national average in the eastern Corn Belt, winter wheat, western cotton, eastern tobacco, southern range livestock, and California specialty areas. In the latter area, nearly 90 percent of the reporters believed land values to be too high.

### Changes Expected in 1960

The predominant opinion of farm real estate reporters as of October 1, 1959, was that prices of farmland would remain about the same for the next 6 months. However, about 20 percent of the reporters expected some increase in price of nonirrigated farmland. This was about the same as the proportion expecting increases in the 1958 survey. Only 5 percent expected prices to decline. The expectation of little change in market prices for nonirrigated

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<sup>1/</sup> The material in this and succeeding sections is based on the replies to a mail survey of the Department's farm real estate reporters made last October. Separate questionnaires were sent to 2 groups of reporters: (1) Farm real estate dealers, and (2) nondealers, including local bankers, lawyers, abstractors, county officials, local representatives of lending agencies, and others familiar with the farm real estate market in their localities. Most of these reporters have participated in similar surveys conducted in March and October each year. As they are in close contact with sellers and buyers and are believed to keep well informed as to current market trends, their opinions are likely to reflect those held generally within their communities.



Table 2.- Farm real estate: Reporters' opinions regarding current levels of land values, selected type-of-farming areas and United States, October 1955, 1958 and 1959 surveys <sup>1/</sup>

Type-of-farming area <sup>2/</sup>	Percentage of reporters who thought current level of land values in relation to net farm income -								
	Too high			About right			Too low		
	1955	1958	1959	1955	1958	1959	1955	1958	1959
	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.
Northeast dairy-----	42	26	39	49	65	55	9	9	6
Lake States dairy-----	38	29	40	49	58	49	13	13	11
General farming-----	48	38	46	41	55	47	11	7	8
Eastern Corn Belt-----	67	61	72	27	36	20	6	3	7
Western Corn Belt-----	44	30	50	49	63	43	7	7	7
Spring wheat-----	27	35	36	61	54	55	12	11	9
Winter wheat-----	61	50	62	32	42	33	7	8	6
Eastern cotton-----	34	30	41	57	59	50	9	11	9
Central cotton-----	44	40	37	48	51	59	8	9	4
Western cotton-----	60	55	58	34	44	38	6	3	4
Northern range livestock--	62	48	52	30	48	40	8	4	8
Southern range livestock--	51	54	58	39	40	33	10	6	10
California specialty-----	62	53	89	36	45	7	2	2	4
United States <sup>3/</sup> -----	48	39	49	44	53	44	8	8	7

<sup>1/</sup> Based on replies to the following question asked nondealer reporters in each survey: Considering current levels of farm income and commodity prices, do you think that current prices for farmland in your area are (a) too high, (b) about right, (c) too low.

<sup>2/</sup> See map, page 2, for location of each area.

<sup>3/</sup> Includes 7 additional areas not shown separately.

farms was characteristic of most areas. In a few areas, however, reporters expressed a general belief that prices were likely to decline to some extent. This indication was most evident in the Corn Belt and spring wheat areas. Expectations as to price changes were much the same for both irrigated and nonirrigated land, with strongest indications of a possible decline present in the same area.

The same question was asked the same group of reporters in the October 1958 and 1955 surveys. In 1958, more than half the reporters considered land values to be priced about right; nearly 40 percent said they were too high. The distribution of opinion in 1955 was almost identical with that in the 1959 survey. In all three surveys, the proportion that believed land values to be too low was small -- in most areas, it was less than 10 percent.

These shifts in opinions tend to reflect farm incomes. At the time of the 1955 survey, farm income had been declining for 4 years and land values had been increasing for 3 years. In 1958, farm income increased for the first time since 1951. In 1959, income again declined. These income changes are reflected in the shift in opinions that values were too high. As income increased in 1958, the proportion who felt that values were too low declined, while in 1959 this proportion increased as income declined. The same shift in opinion was evident in all except two of the major type-of-farming areas.

In the spring wheat area, the proportion of "too high" opinions was about the same in 1958 and in 1959, but it was at a higher level than in 1955. In the central cotton area, however, the number of "too high" opinions as a proportion of the total declined in each survey.

#### Volume of Farm Sales Unchanged

The volume of voluntary transfers of farm real estate in the summer and fall of 1959 was about the same nationally as in the comparable period of 1958. However, indications provided by the October survey showed some variations among areas of the country. Numbers of sales were reported to be greater than a year earlier in the Northeast, Northwest, wheat, and general farming areas.

The cotton areas presented a contrast. Sales volumes declined in the western cotton area, were largely unchanged in the East, and rose in the central cotton area. The wheat areas presented a similar pattern - volume increased in the winter wheat area but declined in the spring wheat area to the north. A large part of this area was hit by drought last summer, which reduced demand somewhat. Sections of the western Corn Belt were similarly affected and this contributed to a decline in sales in that area. Volume was unchanged in the eastern Corn Belt and the neighboring Lake States dairy area, as well as in the range livestock areas of the Mountain States. However, volume was reduced in the two Pacific Coast areas - northwest dairy and California specialty.

The number of distress transfers of farm real estate as a result of foreclosure or transfer to avoid foreclosure has been at a relatively low level for several years (fig. 2). During 1958, the rate of such transfers - 1.6 farms per 1,000 of all farms - was within the low range that has prevailed since 1945. Actual foreclosures have been low for several reasons. One of the most obvious was the generally favorable farm income situation through 1951. Since 1951, however, the strong demand for land has been a significant factor preventing actual foreclosure. This demand made it possible to sell farms on the open market if foreclosure was imminent, and the number of farms that creditors acquired by formal foreclosure action was at an all-time low.

The administrative records of the Farm Credit Administration and life insurance companies provide further indications of the low level of distress transfers in recent years. In 1940, for example, the Federal land banks acquired 5,242 farm properties through foreclosure or similar action. The value of these properties, at \$23 million, was 1.2 percent of the value of all farm mortgages held by the banks at the beginning of the year. The number and value of farm properties acquired declined in the years following until, in 1956, only 50 properties, valued at \$156,000, were acquired. These accounted for one-hundredth of 1 percent of the total value of mortgages held by the banks. Information supplied by 16 life insurance companies, which hold about 22 percent of all farm mortgages, on the status of their mortgage holdings during the 1954-58 period also shows a low incidence of mortgage distress.

The number of mortgages reported by the companies to be in process of foreclosure or in voluntary conveyance to the mortgagee in lieu of foreclosure, ranged from 70 to 112 at the beginning of each quarter in this period. However, only 34 farm properties were actually acquired through foreclosure by these companies during the 5 years.

This generally low incidence of transfers arising from financial distress continued through the summer and fall of 1959. However, farm real estate reporters indicated that the number increased in some areas. These areas were the northeast dairy, Lake States cutover, spring wheat, and the three westernmost areas - western wheat, northwest dairy, and California specialty. Some further decline in distress transfers was reported from the central and western cotton areas. Elsewhere, the number was about the same as in 1958.

### Dealers Report Fewer Listings of Farm Property

Farm real estate dealers in most areas of the country reported that they had fewer farm properties listed for sale this October 1 than on the same date a year earlier (table 3). In three major areas - eastern Corn Belt, spring wheat, and eastern cotton - the number was about the same as a year earlier. A more general observation of market supply was provided by nondealer reporters, who were asked to indicate whether the number of farms on the market during the past summer and early fall was more, about the same, or less than the number a year earlier. The consensus of these reporters was that the number of farms on the market had remained about the same, with some tendency to increase in certain areas. The areas in which the latter indication was strongest included the eastern Corn Belt, spring wheat, western wheat, and California specialty areas. Thus, it appears that the total supply of farmland on the market may have increased last summer, although fewer were listed by farm real estate dealers.

### Reasons Why More Farms Are Not for Sale

The market supply of farmland has been relatively low for several years. In past surveys, reporters frequently provided reasons for this situation. In the October 1955 survey and again this fall, several of the reasons most frequently cited were listed on the survey questionnaire. Reporters - in 1955, dealers only - were then asked to rank the statements in order of their relative importance as reasons why more farms were not for sale in their areas. The statements listed were substantially the same in both surveys, with one exception. In 1955, one possibility listed was that "sales were delayed by the prospect of Social Security benefits." In the 1959 survey, it was revised to "sales withheld to enter land in the soil bank."

The reason that ranked first in all areas in both years was that owners felt that farmland was a safe investment and a good hedge against inflation. Ranking second in all except 5 areas in 1959 was the prospect of the payment of tax on capital gains realized from sales. This reason was ranked no



Table 3.- Average number of farm listings per dealer, 1957-59, and reasons why more farms are not for sale, selected type-of-farming areas and United States

Type-of-farming area <u>1/</u>	Listings per dealer Oct. 1			Reasons why more farms are not for sale <u>2/</u>			
	1957	1958	1959	Safe investment	Present returns	Capital gains tax	Soil Bank
	No.	No.	No.	Rank	Rank	Rank	Rank
Northeast dairy-----	21	15	12	1	3-4	2	3-4
Lake States dairy-----	21	18	15	1	4	2-3	2-3
General farming-----	30	22	15	1	4	2	3
Eastern Corn Belt-----	7	7	6	1	3	2	4
Western Corn Belt-----	13	12	9	1	3	2	4
Spring wheat-----	7	4	5	1	2-3	4	2-3
Winter wheat-----	13	8	7	1	3	2	4
Eastern cotton-----	7	5	5	1	4	3	2
Central cotton-----	23	18	11	1	2	3	4
Western cotton-----	15	15	8	1	3	2	4
Northern range livestock----	13	10	7	1	3	2	4
Southern range livestock----	21	17	8	1	3-4	2	3-4
California specialty-----	13	15	9	1	3	2	4
United States <u>3/</u> -----	16	13	9	1	3	2	4

1/ See map, page 11, for location of each area.

2/ Farm real estate reporters were asked in the October 1959 survey to rank the following factors according to their relative importance as reasons why more farms were not for sale in their area:

- A. Owners feel that farmland is a safe investment and a good hedge against inflation.
- B. No other investments that pay as well.
- C. Capital gains tax discourages sale.
- D. Sales withheld to enter land in Soil Bank.

3/ Includes 7 additional areas not listed above.

higher than third in importance in the eastern and central cotton, eastern tobacco, Lake States cutover, and spring wheat areas. The restriction of supply because of the soil bank was given fourth place in most areas, but ranked as high as second in the Lake States cutover, spring wheat, and eastern cotton areas. In two areas, eastern dairy and general farming, reporters ranked it third, while it shared third place with other reasons in the Lake States dairy, spring wheat, and southern range livestock areas. It ranked the lowest among the listed reasons in only 2 areas, California specialty and Northeast.

In the 1955 survey, the satisfaction of owners with current returns from land was ranked second in importance in most areas. However, reporters in the 1959 survey ranked it as third or lower in all except two areas.



## Number of People Looking for Land Declines

Both dealer and nondealer reporters were in general agreement that the number of people looking for farmland this past summer and early fall was less than in the comparable period a year earlier. This situation generally held for all except 4 of the 12 major eastern type-of-farming areas. Reporters in the eastern dairy, winter wheat, and eastern cotton areas concluded that demand, as measured by inquiries to buy farmland, was about the same as in the earlier period. In the central cotton area, demand may have been a little higher. Indications of a decline were stronger in the western Corn Belt and spring wheat areas. Demand was considered to be generally unchanged in four of the five western areas. The exception was the western wheat area in Washington and Oregon, where it was greater.

Comparisons between prices asked by sellers of farm real estate and actual sales prices provide another measure of the strength or weakness of demand for land. Farm real estate dealers have provided such information for a sample of sales occurring in the 6 months preceding each October survey since 1955. Although one would expect sellers to set initial asking prices somewhat higher than they would be willing to accept, the spread between these two prices should reflect the relative strength or weakness of the market.

When a "sellers market" prevails and prices trend upward, one would expect a smaller difference between asking and selling prices than when a

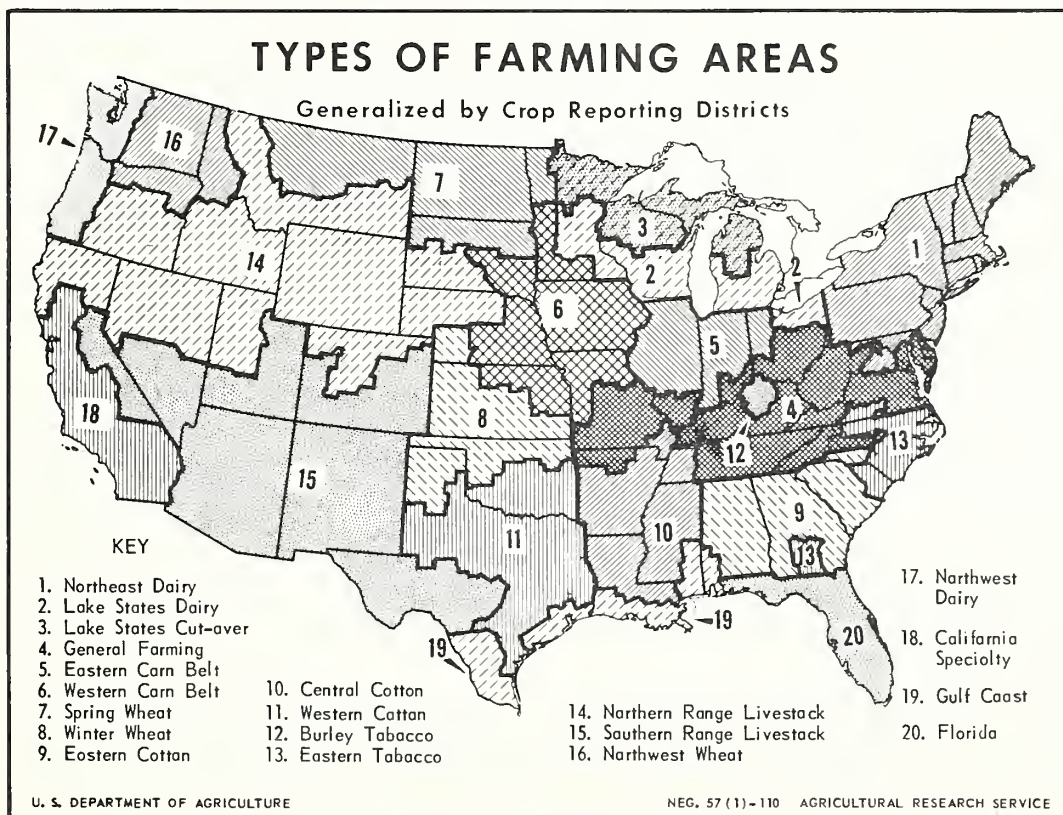


Figure 3

"buyers market" exists and prices are declining. Since 1955, selling prices have averaged very close to asking prices in most areas. Selling prices have seldom been more than 10 percent below asking prices and in most areas in most years the spread has been from 5 to 7 percent. Sales made in the spring and summer of 1959 were no exception. Nationally, selling prices were 5 percent below asking prices. A year earlier, the difference was 4 percent.

Less variation in the ratio of selling to asking prices was evident in 1959 within, as well as between, areas. The range in average ratios was from a low of 92 in the Northeast to a high of 99 in the eastern Corn Belt. However, changes in the level from 1958 were generally minor and showed no consistent pattern. Thus, indications of an increased supply of farmland and reduced demand, mentioned earlier in this report, were not yet strong enough to produce any change in the spread between asking and selling prices.

A measure of the relative importance of demand from various classes of buyers was provided by the dealer reporters in the October survey. They were asked to indicate what proportion of their inquiries to purchase land came from various classes of prospective buyers. Nationally, the proportion of inquiries coming from farmers already owning land, tenants, nonfarm investors, and all other buyers was essentially the same as in 1958 (table 4). Nearly half (44 percent) of the inquiries continue to come from farmers already owning land. Inquiries from this group were most important in the Corn Belt, wheat, and range livestock areas. It is in these areas that farm enlargement has been of greatest importance in the farm real estate market.

About a fifth of the inquiries come from tenant farmers. These prospective buyers are relatively most frequent in the Lake States, Corn Belt, and spring wheat areas where they made up more than a fourth of the inquiries. They sought land much less actively than in 1958 in the eastern cotton and southern range livestock areas. Nonfarm investors were the source of about a fourth of the inquiries. In those areas that were most strongly affected by nonfarm influences, they accounted for about half of the inquiries for farmland, a somewhat higher proportion than in 1958. The areas included were the Northeast, eastern cotton, California specialty, Gulf coast, and Florida. In the more predominantly agricultural areas, inquiries from nonfarmers made up about the same proportion of the total as in 1958. Two exceptions to this were the spring wheat and southern range livestock areas, where such inquiries were less frequent. Those from other nonfarmers made up 14 percent of the inquiries. Together, the two groups of nonfarmers accounted for a more substantial share of the market demand in many areas than in 1958. In the Northeast, for example, two-thirds of the inquiries came from this group. In contrast, only 15 percent of the inquiries in the western Corn Belt and spring wheat areas were reported to be from nonfarmers.

Two other measures of the market situation were provided by dealer reporters in the October survey. They were asked whether the length of time

Table 4.- Demand for farmland: Dealers' estimates of percentage distribution of prospective buyers, selected type-of-farming areas and United States, Mar. 1 to Oct. 1., 1958 and 1959

Type-of-farming area <u>1/</u>	Farmers				Nonfarmers			
	Owner-operators		Tenants		Nonfarm investors <u>2/</u>		All others	
	1958	1959	1958	1959	1958	1959	1958	1959
	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.
Northeast dairy-----	34	24	11	10	23	37	27	29
Lake States dairy-----	22	36	31	23	21	20	16	21
General farming-----	33	35	18	16	33	30	16	19
Eastern Corn Belt-----	54	51	21	23	16	16	9	10
Western Corn Belt-----	53	52	31	33	11	10	5	5
Spring wheat-----	52	57	29	28	15	8	4	7
Winter wheat-----	61	59	10	14	23	20	6	7
Eastern cotton-----	29	23	15	4	37	56	19	17
Central cotton-----	35	35	16	15	36	34	13	16
Western cotton-----	42	46	12	10	32	34	14	10
Northern range livestock-----	58	53	18	13	17	13	7	11
Southern range livestock-----	37	53	17	5	38	30	8	12
California specialty-----	53	40	10	6	21	40	16	14
United States <u>3/</u> -----	45	44	20	19	22	23	13	14

1/ See map, page 11, for location of each area.

2/ It is difficult to make a clear distinction between nonfarmer investors and other nonfarmer buyers in the northeastern dairy, general farming and eastern cotton areas. The proportion of nonfarmer investors may be overstated for these areas.

3/ Averages include 8 areas not listed above.

between the initial listing and sale of the property and the amount of sales effort required to make a sale was more, about the same, or less than in the summer and early fall of 1958. Nationally, the consensus was that slightly more sales effort was required in 1959. This feeling of more sales effort being required in the past year was expressed by reporters in the northeastern dairy, general farming, Corn Belt, central cotton, and southern range livestock areas. Dealers felt that sales were easier to make in 1959 in the Lake States, winter wheat and western cotton, tobacco, and Gulf Coast areas. Elsewhere, the situation was about the same as in 1958.

Dealer reporters in the northeastern and Lake States dairy areas said that the time required to make a sale in the summer and fall of 1959 was about the same as in 1958. In 10 of the remaining 18 type-of-farming areas, dealers thought that more time was required to make a sale in 1959. These areas included the Lake States cutover, general farming, Corn Belt, spring wheat, central and western cotton areas, and California specialty areas. In the remaining areas, reporters noted that less time was required to make a sale.



## Credit Financing of Farm Transfers More Difficult

Reporters in nearly every farming area thought it more difficult to obtain financing for credit-financed transfers this last summer than a year earlier. Indications of increased difficulty were most pronounced in the Corn Belt, winter wheat, western cotton, and southern range livestock areas. Dealer reporters in the Northeast and eastern cotton and tobacco areas were the only ones suggesting little change or some easing in obtaining financing from a year earlier.

The same general indications of a restriction in the supply of credit were provided by nondealer reporters in the October 1959 survey, who were asked to indicate whether the availability of credit had increased, changed little, or decreased from a year earlier. The replies in all areas presented the consensus that less credit was available. Nationally, about a tenth reported increases, a fourth reported decreases, and the rest reported little change. In the 1958 survey, the percentage reporting increases was a fifth while a tenth reported decreases.

The decline in availability of credit was not due to a general shift in appraisal standards of lenders, although reporters in several areas noticed a decline in appraised values. Those opinions were most definite in the Lake States dairy, Corn Belt, spring wheat, and northern range livestock areas. In most areas, however, reporters observed little change, or some increase, in appraised values in 1959.

Along with the general decline in availability of credit, loan limits declined also in many areas. The consensus of dealer reporters in the northeastern and the three southwestern areas - winter wheat, western cotton and southern range livestock - was that loan limits increased somewhat during the year. In no areas did nondealer reporters express a change in that direction.

Interest rates in central money markets have been increasing since mid-1958. For example, the average bank rate of interest on business loans in 19 major cities in September 1958 was 4.21. In September 1959, this rate had advanced to 5.27. Although the cost of farm-mortgage credit has risen also, the increase thus far has been somewhat smaller than for business loans. Rates charged by the Federal land banks have been at 6 percent for all of the 12 banks since December 1959. Rates for the other three major classes of lenders were also higher than a year earlier. Farm real estate reporters in the October 1959 survey estimated that the average rate for individual lenders was 5.8 percent, up only one-tenth of a percentage point from 1958 (table 5). Life insurance company rates were reported to average 5.6 percent and commercial bank rates were 6 percent. The latter two were 0.3 and 0.2 percentage points above 1958. Rates charged by individuals averaged a little lower than in 1958 in the central and western cotton areas



Table 5.- Farm-mortgage interest rates: Averages of reporters' estimates of rates charged, by type of lender, selected type-of-farming areas and United States, October 1, 1957-59

Type-of-farming area <sup>1/</sup>	Individuals			Life insurance companies			Commercial banks		
	1957	1958	1959	1957	1958	1959	1957	1958	1959
	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.
Northeast dairy-----	5.5	5.4	5.5	5.2	5.3	5.6	5.7	5.6	5.7
Lake States dairy-----	5.2	5.1	5.3	5.3	5.3	5.5	5.6	5.6	5.9
General farming-----	6.1	5.8	5.8	5.1	5.4	5.5	6.4	5.9	6.0
Eastern Corn Belt-----	5.4	5.3	5.6	5.2	5.1	5.5	6.1	5.4	5.7
Western Corn Belt-----	5.1	5.0	5.2	5.2	5.1	5.5	5.5	5.3	5.7
Spring wheat-----	6.1	5.4	5.7	5.3	5.4	5.6	6.2	6.1	6.3
Winter wheat-----	6.2	5.7	6.0	5.3	5.3	5.7	6.0	5.7	6.1
Eastern cotton-----	6.9	6.7	6.8	5.7	5.6	5.9	6.6	6.2	6.3
Central cotton-----	6.7	6.6	6.4	5.3	5.5	5.8	6.2	6.3	6.5
Western cotton-----	6.7	6.4	6.1	5.6	5.4	5.7	7.0	6.2	6.3
Northern range									
livestock-----	6.4	5.9	6.0	5.3	5.2	5.6	6.3	6.1	6.3
Southern range									
livestock-----	6.5	6.2	6.3	5.3	5.2	5.6	6.3	6.1	6.4
California specialty---	6.2	5.9	6.4	5.5	5.4	5.9	6.3	5.9	6.3
United States <sup>2/</sup> -----	5.9	5.7	5.8	5.4	5.3	5.6	6.1	5.8	6.0

<sup>1/</sup> See map, page 11, for location of each area.

<sup>2/</sup> Includes 7 additional areas not shown separately.

and were unchanged in the general farming area. Elsewhere, they increased for all types of lenders. This increase in interest rates could cause some prospective buyers to delay purchase of farmland, particularly if they expect interest rates to decline sometime in the next couple of years.

Table 6.- Farm real estate: Index numbers of average value per acre, by States and farm production regions, November 1959 and selected dates 1/

(1947-49=100)									
State and region	1940	1950	1954	1955	1958		1959		
					March	Nov.	March	July	Nov.
Maine-----	69	95	109	104	113	123	125	129	133
New Hampshire-----	67	97	105	105	119	126	129	134	138
Vermont-----	58	101	107	104	120	126	129	133	138
Massachusetts-----	74	99	106	106	126	135	137	143	149
Rhode Island-----	66	101	109	108	133	142	145	150	156
Connecticut-----	65	100	109	111	138	146	149	152	157
New York-----	59	105	117	119	137	142	146	149	149
New Jersey-----	62	103	129	132	168	180	183	189	194
Pennsylvania-----	58	102	130	134	163	169	172	175	175
Delaware-----	55	98	124	130	163	171	177	184	189
Maryland-----	50	99	129	136	167	175	179	185	189
Northeast-----	60	102	121	123	147	154	158	161	163
Ohio-----	46	101	132	141	171	175	173	179	183
Indiana-----	44	103	137	147	173	180	182	185	186
Illinois-----	50	108	139	142	169	176	182	184	183
Iowa-----	51	108	125	133	147	154	157	158	162
Missouri-----	50	106	123	130	156	163	169	169	175
Corn Belt-----	49	106	132	139	162	168	173	174	176
Michigan-----	46	100	128	133	158	162	170	175	173
Wisconsin-----	58	101	113	113	133	136	142	142	143
Minnesota-----	55	109	127	135	171	176	181	185	189
Lake States-----	54	104	122	127	154	159	165	168	169
Virginia-----	48	101	129	135	161	171	174	172	177
West Virginia-----	58	95	107	110	132	139	142	142	145
North Carolina-----	43	106	133	140	161	165	170	171	175
Kentucky-----	42	102	116	115	133	141	145	147	152
Tennessee-----	42	103	116	118	136	143	150	151	153
Appalachian-----	44	103	123	126	146	153	158	159	163
South Carolina-----	43	97	120	121	143	151	155	157	162
Georgia-----	45	99	134	138	171	181	188	192	194
Florida-----	57	97	134	141	213	229	245	254	261
Alabama-----	47	101	125	125	152	161	169	169	171
Southeast-----	48	99	129	132	171	182	191	195	199

See footnotes at end of table.

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Table 6.- Farm real estate: Index numbers of average value per acre, by States and farm production regions, November 1959 and selected dates 1/ - Con.

State and region	1940	1950	1954	1955	1958		1959		
					March	Nov.	March	July	Nov.
Mississippi-----	46	106	135	137	169	179	186	187	187
Arkansas-----	40	105	124	126	154	159	163	163	166
Louisiana-----	57	105	132	138	174	182	192	192	197
Delta States----	46	104	129	132	163	170	177	177	180
Oklahoma-----	50	108	128	136	155	164	168	170	172
Texas-----	55	102	133	137	158	166	169	170	170
Southern Plains--	54	103	132	137	157	165	169	170	170
North Dakota-----	48	107	134	132	162	168	178	177	173
South Dakota-----	47	111	135	139	156	165	171	170	170
Nebraska-----	47	104	127	134	146	152	159	159	157
Kansas-----	45	106	125	129	147	151	156	157	157
Northern Plains--	46	107	129	133	150	156	162	162	161
Montana-----	43	104	142	146	171	180	183	188	195
Idaho-----	43	107	136	142	158	164	169	174	179
Wyoming-----	40	100	123	123	128	134	138	140	144
Colorado-----	37	104	128	128	130	135	138	143	143
New Mexico-----	36	107	135	136	141	145	149	156	156
Arizona-----	40	99	135	137	157	164	168	173	177
Utah-----	49	107	133	137	142	145	150	152	157
Nevada-----	49	99	137	139	153	159	164	166	166
Mountain-----	41	104	134	136	148	154	158	162	165
Washington-----	45	101	132	137	156	164	167	171	171
Oregon-----	41	99	123	128	144	149	152	155	153
California-----	42	94	122	123	158	167	172	175	175
Pacific-----	42	96	124	130	156	165	168	172	171
United States--	49	103	128	133	156	163	168	169	171

1/ All farmlands with improvements as of March 1, except as indicated.

Table 7.- Farm real estate: Index numbers of average value per acre, by States and geographic divisions, November 1959 and selected dates 1/

(1912-14=100)									
State and division	1920	1930	1950	1955	1958		1959		
					Mar.	Nov.	Mar.	July	Nov.
Maine-----	142	124	132	145	163	171	173	179	184
New Hampshire-----	129	111	136	147	167	177	181	188	194
Vermont-----	150	123	176	181	209	219	224	231	240
Massachusetts-----	140	131	152	161	193	207	210	219	227
Rhode Island-----	130	134	184	197	243	260	266	274	285
Connecticut-----	137	140	191	213	264	280	285	291	301
New England-----	140	127	157	169	198	210	214	221	228
New York-----	133	103	152	172	198	206	212	216	215
New Jersey-----	130	125	194	249	317	340	346	356	366
Pennsylvania-----	140	107	157	206	252	262	266	270	270
Mid. Atlantic-----	136	106	157	194	231	241	247	252	252
Ohio-----	159	90	167	234	285	290	295	298	304
Indiana-----	161	80	174	249	293	304	308	312	315
Illinois-----	160	91	162	213	254	263	273	275	273
Michigan-----	154	121	198	263	311	320	337	346	342
Wisconsin-----	171	117	145	162	191	196	204	204	206
E. N. Central-----	161	96	166	219	261	269	278	281	281
Minnesota-----	213	133	169	210	265	274	280	288	293
Iowa-----	213	113	158	195	215	226	229	232	237
Missouri-----	167	92	124	153	183	191	198	198	205
North Dakota-----	145	95	115	142	175	181	192	190	186
South Dakota-----	181	93	97	121	136	144	149	148	149
Nebraska-----	179	113	130	167	182	190	198	198	196
Kansas-----	151	113	169	205	233	241	248	249	249
W. N. Central-----	184	109	142	177	203	211	218	219	221
Delaware-----	139	111	158	210	262	275	286	296	305
Maryland-----	166	123	199	273	335	352	359	372	380
Virginia-----	189	134	235	313	375	397	405	399	412
West Virginia-----	154	105	139	161	194	204	209	209	213
North Carolina-----	223	158	341	451	518	532	547	552	563
South Carolina-----	230	104	203	253	298	315	324	329	339
Georgia-----	217	100	181	252	313	330	344	350	354
Florida-----	178	172	226	328	497	535	572	592	610
S. Atlantic-----	199	127	224	300	371	390	404	410	419

See footnotes at end of table.

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Table 7.- Farm real estate: Index numbers of average value per acre, by States and geographic divisions, November 1959 and selected dates 1/ - Con.

(1912-14=100)									
State and division	1920	1930	1950	1955	1958		1959		
					Mar.	Nov.	Mar.	July	Nov.
Kentucky-----	200	127	272	308	358	379	388	393	407
Tennessee-----	200	123	265	303	350	367	385	390	394
Alabama-----	177	143	260	321	391	412	433	434	440
Mississippi-----	218	122	244	317	391	414	429	432	432
E. S. Central----	199	123	263	311	368	389	404	408	415
Arkansas-----	222	141	247	297	364	374	384	384	391
Louisiana-----	193	132	221	291	366	384	404	404	416
Oklahoma-----	166	127	202	254	289	307	315	319	322
Texas-----	174	138	184	248	285	299	305	307	307
W. S. Central----	177	136	192	254	294	308	316	318	319
Montana-----	126	82	132	186	218	229	233	239	248
Idaho-----	172	130	230	307	341	353	365	376	385
Wyoming-----	177	111	183	225	234	244	252	257	264
Colorado-----	141	89	161	198	202	210	215	221	221
New Mexico-----	144	112	232	295	307	316	325	339	339
Arizona-----	165	139	218	304	347	364	372	383	393
Utah-----	167	125	179	229	238	243	251	255	263
Nevada-----	135	98	132	186	205	213	220	222	222
Mountain-----	148	103	175	229	249	259	265	273	278
Washington-----	139	113	210	285	325	342	348	357	357
Oregon-----	129	111	176	226	254	264	268	274	272
California-----	167	164	220	301	370	393	402	409	409
Pacific-----	157	147	212	287	345	364	373	380	379
United States--	173	114	174	224	262	274	282	285	287

1/ All farmlands with improvements as of March 1, except as indicated.

## RETURNS TO PRODUCTIVE CAPITAL IN AGRICULTURE

By William H. Scofield

If agriculture is viewed as one large business in which the various types of productive assets of all firms are combined, the capital structure of the industry can be analyzed and changes observed over time. By applying appropriate accounting techniques, returns to the various factors can be estimated. 1/ The rate of return to farm real estate is based on its current market value each year and is compared with the rate of return on common stocks, calculated in a similar way. The resulting rates do not reflect the earnings of present owners who acquired farmland or stocks at lower prices than those prevailing currently. Major attention is given to returns to real estate because of its importance in the capital structure of agriculture and the special nature of its valuation. Returns to non-real-estate capital and to operator and family labor also are estimated.

Productive capital includes those assets used directly in farm production, and they are valued at the prevailing market price each year. 2/ Certain assets, particularly operators' dwellings, a part of the value of automobiles on farms and financial assets in excess of those needed as working capital which are ordinarily included in a combined balance sheet of agriculture, are excluded. A distinction is made also between "internal capital," or that provided by persons (operators and landlords) within the agricultural sector, and "external capital" that is borrowed from the nonfarm sector.

The total value of assets used in farm production was about \$152 billion in 1959. 3/ This was about \$60 billion more than in 1950 and four

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1/ Several other studies concerned with returns to factors in agriculture should be noted, including the following: Johnson, D. G. Allocation of Agricultural Income, Jour. Farm Econ. Vol. 30, Nov. 1948, pp. 724-745; Hurlburt, V. L., Distribution of Income from Land, 1958 Yearbook of Agriculture, pp. 176-182; Hurd, E. B. Allocation of Net Farm Income, Agr. Econ. Research, Vol. IX, Jan. 1957, pp. 10-18.

2/ As with unincorporated nonfarm businesses, difficult conceptual and measurement problems are involved in separating the assets associated with farm production from those associated with family living. A partial solution to this problem has been achieved by removing the value of farm operators' dwellings and the family share of the value of automobiles from total assets and by taking only a part of the liquid financial assets shown in the Balance Sheet of Agriculture to represent working capital. Comparable adjustments should be made in the estimates of total borrowed capital (debts) that are associated with the operator's dwelling and family living expenditures. As the basis for these adjustments is less adequate than in the case of assets, the total amount of borrowed capital shown as used in farm production may be slightly overstated.

3/ This estimate is slightly lower than that shown in the Balance Sheet of Agriculture because only half of the value of the stocks of feed grains and forage on farms on January 1 is taken and stocks on farms owned by the Commodity Credit Corporation are excluded.

times the amount in 1940. About three-fourths of all assets are in farmland and service buildings and one-fourth is in various types of non-real-estate. These include livestock, machinery and equipment, stocks of feed grains and forage on farms, and working capital. Although much of the increase in total capital has resulted from the higher value per acre attached to land and buildings, the acreage of land and the physical quantities of most non-real-estate items have also increased. Even so, only slight departures from the current ratio of real estate to non-real-estate capital of about 3 to 1 can be observed in the last 20 years. Non-real-estate capital increased to about a third of all capital in the early forties because of the slower rise in the value of real estate. It reached this proportion again in the early fifties when inventory values of livestock and of machinery and equipment increased more than the value of real estate. Since 1956, however, the 3 to 1 relationship has changed very little.

Although agriculture is an industry that traditionally has been self-financed, some marked changes have occurred in the proportion of total productive capital provided by borrowed funds. In 1940-41, about a fourth of the total capital used was borrowed, but the proportion declined rapidly during the World War II years to a low of about 10 percent in 1946-49. Borrowed capital as a percentage of total capital increased steadily through 1954 but has since remained at about 14 percent. <sup>4/</sup>

In addition to the borrowed funds utilized to acquire productive assets, an important part of the farm real estate capital is "borrowed" by farm operators under cash and share-rent arrangements. In 1959, about 36 percent (\$45.6 billion) of the total value of all farm real estate (including operators' dwellings) was rented. Gross rental payments (before landlord's expenses) for the use of this capital amounted to about \$3 billion. However, as nearly 40 percent of the value of rented real estate is owned by farm operators, only that part of the real estate capital that is owned by nonfarm landlords is supplied from outside the agricultural sector. In 1959, nonfarmers provided about \$28 billion in real estate capital and received about \$1 billion in net rental income. <sup>5/</sup>

Combining the borrowed capital represented by debts to lenders and the value of real estate rented from nonfarmers gives an approximation of the extent to which farm operators utilize productive capital owned by others. In

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<sup>4/</sup> Data do not permit a division of borrowed capital between the part that is provided by farmers to other farmers, and the part obtained from the non-farm sector. This distinction is relevant in refining the capital accounts of the two sectors to more accurately measure flow of funds. Because the calculations followed here assume that all borrowed capital is obtained from the nonfarm sector, the proportion attributed to this sector is somewhat overstated.

<sup>5/</sup> Landlords also provide a significant amount of non-real-estate capital under livestock-share-leasing arrangements and occasionally under crop-share leases. However, no estimates of the total amount of such capital are available.



1959, these two sources of external capital totaled about \$50 billion, or nearly 30 percent of the total value of all assets of \$166 billion (including operators' dwellings). 6/

### Allocation of Returns to Productive Capital

Although no entirely satisfactory basis exists for determining the net return attributable to each of the various factors of production, an approximation can be made based upon certain assumptions. As these assumptions directly affect the results, they should be clearly understood.

- (1) All inputs used in production that have a market cost are charged at their cost. This applies to both annual operation expenses, such as feed, seed, and fertilizer, and to borrowed capital.
- (2) An opportunity cost rate is charged for owned capital and for operator and family labor. In the case of both real estate and non-real-estate capital, an interest charge is made comparable to that realizable from alternative investments. A charge is made for operator and family labor by applying the hourly cash wage rate for hired farmworkers to the number of manhours used in farm production. This rate has ranged from \$0.21 per hour in 1940 to \$0.98 cents in 1959.
- (3) The residual or surplus of income remaining after all productive inputs are paid for at market or opportunity cost rates is considered as the return for risk and uncertainty. It can be allocated at the discretion of the entrepreneur, to any one or to each factor. In the present calculations, the residual is allocated equally to owned real estate capital and to operator and family labor.

The first step in the analysis was to calculate a rate of return to all capital and to owned capital (table 8). Although the rates fluctuate considerably from year to year, a downward trend is evident, especially since 1951. In all years between 1940 and 1954, the rate of return on all capital exceeded the interest rate paid on borrowed capital. Consequently, the rate on owned capital was a little higher than for all capital. The reverse has been true since 1954. The preliminary estimate of 3.5 percent for all capital in 1959 is the lowest in the 1940-59 period, and appreciably below the interest rate on borrowed capital. This means that a part of the return on owned capital or operator and family labor must be allocated to pay the cost of borrowed capital.

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6/ Although the value of operators' dwellings on rented land is not excluded from the value of real estate cited in these estimates, the proportion of productive assets provided by nonfarm landlords would not be affected appreciably.



Table 8.- Returns to capital used in agricultural production, United States, 1940-59

Year	Net income from agriculture 1/	Imputed cost of all farm labor 2/	Return to all farm capital 3/	Value of assets used in farm production 3/	Borrowed capital 4/	Rate of return 5/		
(1)	(2)	(3)	(4)	(5)	Amount (6)	Cost (7)	All capital (8)	Owned capital 6/ (9)
	Million dollars	Million dollars	Million dollars	Million dollars	Million dollars	Million dollars	Percent	Percent
1940-----	6,257	4,298	1,959	37,659	9,590	479	5.2	5.3
1941-----	8,710	5,211	3,499	38,965	9,841	504	9.0	10.3
1942-----	12,651	6,998	5,653	44,698	9,858	485	12.6	14.8
1943-----	15,034	9,134	5,900	52,587	9,127	440	11.2	12.6
1944-----	15,124	10,889	4,235	59,696	8,282	409	7.1	7.5
1945-----	15,782	11,305	4,477	65,260	7,661	391	6.9	7.1
1946-----	19,158	11,753	7,405	71,116	6,628	403	10.4	10.9
1947-----	19,771	12,037	7,734	80,217	7,348	442	9.6	10.0
1948-----	22,174	12,288	9,886	88,770	9,154	495	11.1	11.8
1949-----	16,913	11,017	5,896	94,860	10,198	545	6.2	6.3
1950-----	17,984	10,445	7,539	92,771	10,813	607	8.1	8.5
1951-----	20,609	11,681	8,928	109,620	12,284	696	8.1	8.5
1952-----	19,548	11,684	7,864	122,402	13,939	638	6.4	6.7
1953-----	17,309	11,396	5,913	118,350	14,878	694	5.0	5.0
1954-----	16,661	10,617	6,044	113,712	14,716	749	5.3	5.4
1955-----	15,723	10,456	5,267	117,506	15,575	815	4.5	4.4
1956-----	15,762	10,434	5,328	122,614	16,986	875	4.4	4.2
1957-----	15,982	10,014	5,968	130,176	17,878	982	4.6	4.4
1958-----	18,611	10,215	8,396	138,709	19,001	1,068	6.1	6.1
1959 7/---	16,231	10,895	5,336	152,163	20,728	1,155	3.5	3.2

1/ Net income of farm operators including inventory changes; cash wages and value of perquisites furnished to hired labor; interest on farm mortgage and non-real-estate debt; and net rents paid nonfarm landlords. That portion of the imputed rental value of operators' dwellings consisting of an interest charge on the market value of such structures was deducted from the net income of farm operators.

2/ Average cash wage rate per hour multiplied by the total number of man-hours used in farmwork. Estimates for 1940-58 differ from those shown in ARS 43-74, p. 25, because of downward revisions in number of man-hours.

3/ Market value of farmland and buildings (March 1), excluding value of operators' dwellings; livestock and machinery and equipment (January 1), excluding the family-living share of automobiles; that portion of demand deposits used in farm production; and one-half the market value (January 1) of stocks of feed grains and forage stored on farms, excluding CCC loans.

4/ Farm mortgage and non-real-estate debt, excluding CCC loans.

5/ Rates of return are based upon current market values of assets each year, rather than the original cost.

6/ Value of owned capital derived by deducting total amount of borrowed capital (col. 6) from total value of all capital used in farm production (col. 5).

7/ Preliminary.

The general decline since 1950-51 in the rate of return on productive capital in agriculture is due chiefly to the continued increase in the market value of assets, particularly real estate, without a corresponding increase in the net return available for all factors. The decline in number of man-hours of labor used in farm production has been almost entirely offset by the rise in hourly wage rates. Consequently, the charge for labor has remained essentially constant since 1950 and the return available for capital has fluctuated almost directly with total net income.

### Residual Returns to Real Estate

If both operator and family labor and non-real-estate capital are paid at their respective cost rates, a residual remains that can be allocated as a return on real estate capital (table 9). If the cost of borrowed capital secured by real estate is subtracted, a rate of return on owned real estate capital can be obtained. This procedure is roughly comparable to that followed in corporate accounting to arrive at net earnings. Because values of both land and common stocks are based primarily on current and prospective earnings, some similarity in the rates of return to the two types of capital would be

Table 9.- Returns on market value of farm real estate used in agricultural production, United States, 1940-59

Year	Return to all farm capital 1/	Imputed cost of non-real- estate capital 2/	Return to real estate capital 3/	Value of farm real estate 3/	Borrowed capital secured by real estate		Rate of return on real estate capital 4/	
					Amount	Cost	All	Owned
	Million dollars	Million dollars	Million dollars	Million dollars	Million dollars	Million dollars	Percent	Percent
1940----	1,959	471	1,488	27,860	6,586	293	5.2	5.4
1941----	3,499	542	2,957	28,618	6,494	284	9.4	10.7
1942----	5,653	685	4,968	31,290	6,376	272	14.2	16.2
1943----	5,900	787	5,113	34,943	5,956	246	12.6	13.8
1944----	4,235	827	3,408	40,601	5,396	230	7.5	7.8
1945----	4,477	800	3,677	45,505	4,941	221	7.1	7.4
1946----	7,405	804	6,601	51,527	4,760	219	11.4	12.0
1947----	7,734	987	6,747	58,022	4,897	225	10.8	11.4
1948----	9,886	1,200	8,686	62,368	5,064	232	13.4	14.2
1949----	5,896	1,429	4,467	64,905	5,288	243	7.0	7.3
1950----	7,539	1,424	6,115	63,504	5,579	264	8.3	8.6
1951----	8,928	1,703	7,225	73,950	6,118	291	8.8	9.2
1952----	7,864	1,781	6,083	81,917	6,676	319	7.4	7.7
1953----	5,913	1,631	4,282	82,198	7,263	347	5.3	5.4
1954----	6,044	1,447	4,597	80,656	7,772	373	5.4	5.5
1955----	5,267	1,395	3,872	84,957	8,289	405	4.3	4.2
1956----	5,328	1,420	3,908	90,511	9,066	446	4.0	4.0
1957----	5,968	1,578	4,390	97,016	9,908	487	4.3	4.2
1958----	8,396	1,730	6,666	102,639	10,507	524	6.0	6.2
1959 5/-	5,336	1,949	3,387	110,753	11,263	580	3.0	2.8

1/ From col. 4, table 8.

2/ Interest and service costs paid on non-real-estate debt plus an interest allowance on owned non-real-estate capital. The interest rate used for owned capital was derived by giving equal weights to the rates for Government bonds, dividends on common stocks, and farm mortgages.

3/ Farmland and buildings, March 1, excluding value of operators' dwellings.

4/ Based on the current market value of farmland and buildings (excluding operators' dwellings) as of March 1 of following year, rather than the actual prices paid by owners for their farms.

5/ Preliminary.

expected. The earnings-price ratio for a representative group of common stocks is used as the measure most nearly comparable to the calculated return to farm real estate (fig. 4).

In 1946-49, prices of both land and common stocks were relatively low in relation to earnings. Uncertainty as to the permanence of the high earnings in both industry and agriculture in that period was probably the main factor preventing their full capitalization into market values. Beginning in 1950, market forces capitalized the still favorable earnings into progressively higher capital values for both land and stocks. This trend continued into 1959 and has resulted in an unusual situation with respect to recent valuations for land. Returns on market values have been below the interest rate on farm mortgage loans in 4 of the last 5 years, and in 1959, the return of 3.0 percent was the lowest in more than 20 years. The rate of return on original cost of most of the farm real estate owned currently would, of course, be substantially higher. It seems likely that holders of both stocks and farmland often compute their returns on the basis of costs, rather than on current value.

The low earnings-price ratio for farmland in recent years has serious implications to heavily indebted landowners and to those contemplating the purchase of land for farming purposes. It also suggests the probability that market forces will bring increasing downward pressures on market values to

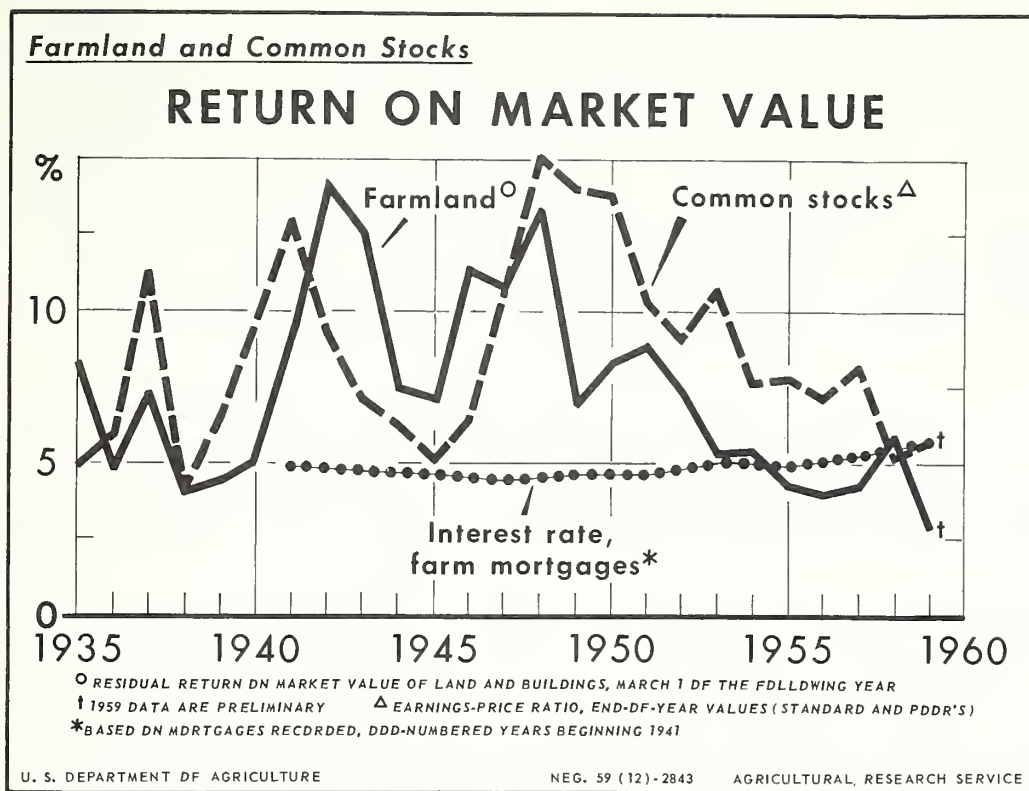


Figure 4

achieve a more favorable relationship between land returns and market values. Higher current returns possible from alternative investments are likely to dampen interest in the continued ownership of land and its purchase as an investment except where capital gains are anticipated. However, with the upward rise in market values slowing perceptibly in 1959, it seems unlikely that capital appreciation of agricultural land in the foreseeable future will be as large as that of the past.

### Distribution of Net Income Among Factors

An approximate division of net farm income among production factors can be obtained by following the third assumption stated previously. Instead of assigning all return above costs to real estate capital, the surplus remaining is divided equally between real estate and operator and family labor. A charge is made for real estate capital, using the rate of interest realizable from alternative investments, plus half the surplus remaining after all factors are charged at cost. A similar procedure is followed for operator and family labor. Hired labor and non-real-estate capital are paid at their cost and do not share in the surplus.

The surplus above costs that is available for allocation to real estate and unpaid labor has varied widely as a percentage of net farm income in the 20-year period. It amounted to about one-fourth of total net income in several war and postwar years, but declined to less than 10 percent in most years since 1953. A negative value resulted in 1959, indicating that income was not sufficient to pay all factors at their market or opportunity cost rates.



Expressing the adjusted returns to each factor as a percentage of total net income reveals long-term trends in returns to factors (fig. 5). Between 13 and 17 percent of total net income has been paid to hired labor in the 20-year period. A slight upward trend is apparent. Operator and unpaid family labor received 55 to 60 percent of net income in most years in 1940-49. A downward trend in the proportion since 1949 is apparent; it reached a low of 43 percent in 1959. The indicated return per hour was above the cash wage rate in all years except 1959. If all labor, both hired and family, is viewed as a single input, an almost steady decline in the proportion of total income allocated to labor is apparent. This is consistent with the decline in number of farms and the increase in labor efficiency.

Non-real-estate capital has claimed a slowly increasing share of total income. Averaging only 4 to 6 percent of the total in the 1940's, it has advanced to 9 to 10 percent in most years since 1950. Most of this increase stems from the rising proportion of borrowed capital in total non-real-estate capital, the cost of which exceeds the return realizable on owned capital.

The share of net income assigned to real estate by these calculations shows a slight upward trend over the period. It dropped to a low of about 17 percent in 1944-45 and reached a high of 30 percent in 1958. The proportion indicated for 1959 - 25 percent - is about the same as that in 1948-52 and in the early forties. As with operator and family labor, the returns available for real estate capital in 1959 were a little smaller than the opportunity cost rate for capital and substantially below the interest cost of funds secured by real estate mortgages.

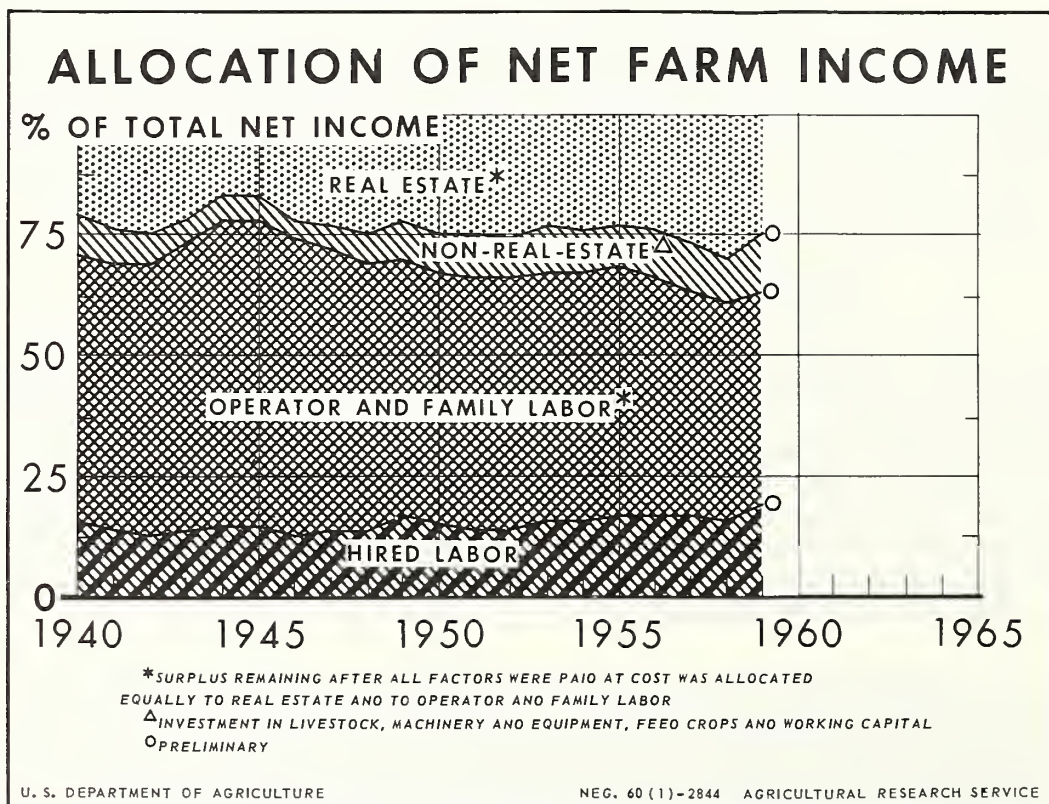


Figure 5

## TAX ASPECTS OF TRANSFERRING OWNERSHIP OF FARM REAL ESTATE

By William H. Scofield, Frederick D. Stocker, and Paul L. Holm

"Should I sell my farmland now?" This is a question that arises with most owners at some time. The answer, of course, depends upon many considerations. One of these considerations is the subject of this article. It is the tax liability that may be incurred under the various choices a person has in transferring ownership of real property.

Tax considerations have assumed new importance to owners of farm and nonfarm real estate because of the nature of the taxes involved and the large capital gains that have accrued during the average length of ownership. Federal tax provisions with respect to capital gains, estates, and gifts are discussed in this article. One or more of these taxes will probably be involved in any of the four general choices an owner has in disposing of his property. These are: (1) Sell the property in the open market; (2) exchange or trade the property for other property; (3) transfer the property to heirs before death by gift or sale, and (4) retain the property until death and allow it to pass to the heirs. Knowledge of the tax implications of these alternatives can help both present and prospective owners to accomplish their objectives of estate planning and management.

The first section of this article discusses in some detail the taxes involved. This is followed by a discussion of the various tax provisions that affect the open-market sale of property or a trade. Later sections deal with the alternatives to open-market sale or trade. No attempt is made to include the many special tax situations that arise in specific cases. Instead, the purpose is to bring together in broad outline some of the tax considerations that affect the transfer or sale of real estate, with particular reference to farm real estate. Reference to such Internal Revenue Service publications as "Farmers' Tax Guide" and "Your Federal Income Tax" is advised for more detailed explanation of specific points. Before proceeding with a particular course of action, consultation with competent lawyers and tax specialists is advisable to determine the legal implications and the tax obligations that will result.

### Types of Taxes Discussed

The Federal income tax applies to capital gains realized on the sale of assets. A long-term capital gain occurs when the net sale price of an asset held for more than 6 months exceeds the adjusted cost basis of the property. Besides being taxable as income on Federal tax returns, such gains are taxable under most State income tax laws. Under Federal law, half of the

long-term capital gain is added to current income in the year of sale and taxed at the same rate as other income, up to a maximum of 50 percent.

Federal estate taxes are imposed on estates that amount to \$60,000 or more. Federal law also places a limit on the amount of property that can be given away tax-free. Gifts of present interests amounting to \$3,000 or more are subject to a gift tax. The rate is about three-fourths of the estate tax rate. In addition to this annual exemption, each person has a lifetime exemption of \$30,000, against which any excess over his annual exemption is applied. Thus, for example, a man and wife who have never given away more than their annual exclusion may, in one year, give a total of \$66,000 worth of property to one person without tax. Thereafter, they can together continue to transfer property by gift, so long as not more than \$6,000 goes to any one person in any one year. <sup>1/</sup>

### Arriving at the Adjusted Cost Basis

Determining the adjusted cost basis of real property is an essential first step before an owner can learn the tax implications of alternative methods of transfer. <sup>2/</sup> Although the purchase price or fair market value at the time the property was acquired is the initial starting point, a number of adjustments must be made in this figure. In general, the original cost or value is increased by certain types of outlays: (1) Those for making improvements and betterments having a life of more than one year, (2) acquiring the property, (3) defending and protecting titles, and (4) other capital expenditures that were not charged against current income. The original basis is reduced by (1) depreciation, (2) amortization, (3) obsolescence, and (4) depletion.

In the case of a typical farm, the original cost must be divided between the land and the buildings, if any. If the property has been occupied by the owner, the value of the dwelling must be estimated apart from the value of the farm service buildings. This distinction is not necessary if the dwelling has been occupied by a renter. Although land is not subject to depreciation for tax purposes, depletion, such as the sale of timber, surface-mined minerals, oil and gas, reduces the original cost basis in the same way. More frequently, however, the owner has made capital investments in the land that should be recognized in figuring the adjusted cost basis. Beginning in 1954, certain types of expenditures such as those for grading, terracing and water-control structures, have been deductible as current operating expenses at the option of the taxpayer. Of course, the cost of

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<sup>1/</sup> If the donor dies within 3 years of the time of the gift, however, the gift is presumed to have been made in contemplation of death, and an amount equal to the value of the gift is included in his estate for tax valuation purposes, unless proof is offered to the contrary.

<sup>2/</sup> See Appendix, pages 38 to 40, for a description of index numbers of farm real estate values and how they may be used in certain valuation problems.



such expenditures cannot be added to the basis of the property if the taxpayer chose to charge them off as current expense. The cost of most other types of permanent improvements to land, such as clearing, drainage, tilling, irrigation, wells and ditches, can be added to the original cost, less any depreciation that has been taken or is allowable.

The adjusted cost basis of farm buildings (other than for an owner-occupied farm dwelling) is determined by adding the costs of improvements to the original cost and then deducting the depreciation taken or allowable. Past tax returns provide the information needed for making these calculations.

### Installment Sale Given Special Capital Gain Treatment

Federal tax law, as well as the laws of some States, permit the capital gains realized from the sale of certain classes of assets to be distributed over a period of years if certain terms of sale are met. The purpose is to relieve the taxpayer of paying taxes on gains before they are actually realized. Because of the graduated tax structure, spreading the gain over several years can reduce the total amount of tax to be paid.

A sale of farm real estate in which the total payments (downpayment plus initial installment) in the year of sale do not exceed 30 percent of the sale price can qualify for this special treatment of capital gains. Although similar provisions apply to certain other classes of assets, the discussion here is restricted to the sale of farm real estate. The seller must receive a mortgage, note, contract, or other evidence of debt from the buyer for the unpaid portion of the sale price. If he sells or discounts such evidences of debt and thus realizes the full proceeds from the sale, it no longer qualifies as an installment sale.

Although the seller of farm property could give a deed to the property and take back a mortgage for the unpaid balance, the land contract is the legal device that is used most frequently to implement an installment sale. The contract sale differs from the conventional deed and mortgage sale in that title remains with the seller until all payments on the contract have been made up or until a specified percentage of the purchase price has been paid. The difference between the contract price and the adjusted cost basis represents capital gain. The total gain is then expressed as a percentage of the contract price. This percentage is then applied to the downpayment and to each installment payment to determine that part of the payment that is capital gain. Thus, if a gain of \$10,000 is realized from a property sold for \$50,000, 20 percent of the downpayment and of each subsequent payment would be capital gain and should be included as such on the tax return for the year in which the payment is received.

As the total gain to be received is known at the time of sale, it is possible to adjust the term of the contract to hold the amount of gain to be



received each year below the taxable level under certain tax situations. The number of exemptions and the amount of income from other sources the seller expects to receive during the life of the contract determines the minimum term of the contract needed to accomplish this objective. Under present Federal tax law, husband and wife under 65 years of age who file jointly and take the standard 10-percent deduction can receive up to \$1,325 per year tax-free. If they are 65 or over, and hence entitled to double exemption, they can receive up to \$2,675. The amount of capital gain that they can receive in any one year without being subject to tax is twice the difference between these maximum income levels and their other taxable income. Both situations are illustrated in table 10.

Table 10.- Minimum term of contract needed to avoid tax on capital gain under certain tax situations, by specified amount of total gain

Item	Minimum term needed if total capital gain is- <u>1/</u>			
	\$5,000	\$10,000	\$15,000	\$20,000
	<u>Years</u>	<u>Years</u>	<u>Years</u>	<u>Years</u>
Age of operator: <u>2/</u>				
Under 65 :				
With other taxable income				
of-				
\$250-----	3	5	7	10
\$750-----	5	9	14	18
\$1,000-----	8	16	24	30
65 years old and over:				
With other taxable income				
of-				
\$500-----	2	3	4	5
\$1,000-----	2	3	5	6
\$1,500-----	3	5	7	9
\$2,000-----	4	8	12	15

1/ In each instance, amount shown is the difference between the net sales price and the adjusted cost basis. Only half of this amount would be recognized as income.

2/ Calculations assume that husband and wife file joint returns and take the standard 10-percent deduction. Interest received on the unpaid portion of the contract must be counted as a part of the "other taxable income."

The case of a husband and wife 65 or over who expect to receive \$1,500 per year from all other sources, including interest on the unpaid balance, is used to show how the table is constructed. They can receive an additional \$1,174 per year (\$2,674 minus \$1,500) without being subject to tax. If they realize a total capital gain of \$15,000 on the sale of their farm, half of this amount (\$7,500) is taxable. If this amount is received over a period of 7 years, the annual income from the capital gain is \$1,071, or slightly less than the maximum allowable (\$1,174). Thus the total gain of \$15,000 could be absorbed as annual income without any tax being paid.

Minor adjustments would be needed in the terms shown if the initial payment were larger or smaller than the subsequent annual payments. If the downpayment were larger than the annual payments specified, some tax obligation would be incurred the first year, but the annual gains received in subsequent years would be below the taxable limits. Also, no allowance is made for the amount of interest that would be received on the unpaid balance, which depends on the amount of the unpaid balance and the interest rate. However, it must be estimated for each situation, keeping in mind that the amount of interest to be received annually declines as each payment is made, and that under present law the personal exemption will double when the taxpayer reaches age 65.

Beyond a certain income level, sellers cannot avoid tax on capital gains altogether, but they can adjust the terms of their contracts so that when annual gains are added to their regular incomes, they are not forced into higher tax brackets. Thus, married taxpayers filing jointly and having \$6,000 in taxable income currently pay 22 percent of the excess over \$4,000. They could receive up to \$8,000, and it would be subject to the same rate. The difference of \$2,000 could be received as taxable capital gains, which would be taxable at the 22-percent rate. If they received \$3,000 gain, \$1,000 of this amount would be taxed at 26 percent. 3/

#### Exchanges of Real Estate

Persons may wish to dispose of a farm or tract of land in order to acquire another of a different size, type, or location. This may be accomplished by a trade or an exchange of property that will effect tax savings compared with outright sale and purchase. For example, a farmer or rancher who owned scattered tracts of land that were not convenient to operate could exchange such parcels for other land that was located close to his base of operation. Farm real estate held for operation or investment can be exchanged for city rental property. The tax considerations involved in such trades or

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3/ A formula that may be used by a married couple, if both are age 65 and over, to compute the required number of years is as follows:

$$\text{Years} = \frac{\text{Amount of capital gain}}{2 \times (2675 - \text{other income})}$$

If both are under age 65, \$1,325 should be substituted for \$2,675.

exchanges differ to some extent from those in an open-market sale. Under certain circumstances, such trades or exchanges can be made under the provisions of the law which result in nontaxable transactions.

If an exchange is to be nontaxable, it must involve exchange of business or investment property for other business or investment property. Thus, the exchange of real estate for real estate and personal property for personal property are exchanges of like property, if used in a business. If the properties exchanged are of equal current value, the property received acquires the same cost basis as the property owned previously. If the new property is later sold, there is no tax saving. However, recognition of any capital gain in the property is postponed, and this is often the main objective of the trade. A tax-free exchange might be advantageous, for example, to the owner of farmland that is in the path of an expanding urban center, for if he sold his land, it is likely that he would pay taxes on a large capital gain. If such land was traded for other land equally suited to farming operations, or for city rental property, recognition of the gain for tax purposes would be delayed. If the property acquired is held until death, it would acquire a new cost basis as of that date. Estate and inheritance taxes are not affected by the fact that the deceased had acquired the property by a trade. If the new property were sold before death, the timing of the sale could be adjusted to the year or period in which the tax on the gains would be most advantageous to the owner.

Postponement of taxes on capital gains can conserve working capital that would be lost if a property were sold and the proceeds, less the tax on capital gains, were reinvested. If an increase in exemptions because of age, or a reduction in other taxable income is anticipated in later years, an installment sale of the property at that time could reduce the amount of taxes that would eventually be paid.

The tax-free exchange can be used also to increase the depreciation base of a property owner and thus reduce taxes on annual incomes. To illustrate, suppose Brown owns a farm that has an adjusted cost basis of \$50,000 for land and \$10,000 for buildings. Although the buildings were originally valued at \$40,000, they have been depreciated to \$10,000 and the remaining depreciation that can be taken would have a relatively low tax-reducing value. The farm has a current value of \$100,000 and can be traded for a 10-unit apartment building of like value, but \$80,000 can be allocated to the structure and \$20,000 to the land. If the farm is traded for the apartment building, the cost basis of the building and land becomes \$60,000, the same as that for the farm, but 80 percent, or \$48,000, of this amount is allocated to the structure. Thus, Brown has acquired an additional \$38,000 (\$48,000 minus \$10,000) in depreciation allowance that can be charged against annual income.

The provisions relating to tax-free exchanges are mandatory, rather than elective, and they apply to losses as well as to gains. Consequently,



in some situations, particularly those in which capital losses can be taken, a trade would prove to be more costly taxwise than a conventional sale and purchase. Such possible disadvantages, as well as the advantages, should be explored carefully from the standpoint of a particular tax situation before entering into a trade.

#### Gain on Farm Residence not Taxable Under Certain Conditions

Persons who sell farm real estate can take advantage of the same provision concerning nontaxability of gains on farm residences as can sellers of urban residences. If another residence is purchased within one year before, or one year after, the sale, and its cost equals or exceeds the adjusted sale price of the old residence, that part of the total gain assigned to the residence is not taxable. The same provision applies if the seller starts construction of a new dwelling within 1 year before or after the sale of his old residence and occupies it within 18 months after the sale. Many retiring farmers buy houses in town or smaller retirement places and thus qualify for this tax provision. It applies also to the residence on another farm which the seller may buy if he occupies it; it does not apply if the residence is occupied by the farm tenant or other renter.

Because the residence on a farm is seldom priced apart from the land and service buildings, both purchase price and sales prices of the residence must be estimated to determine the nontaxable part of the total gain. <sup>4/</sup> The allocation of values for the three classes of assets usually sold as a unit is illustrated in the following tabulation:

Asset	: Purchase : price	: Adjusted : cost basis	: Net sales : price <sup>1/</sup>	: Capital : gain
	: <u>Dollars</u>	: <u>Dollars</u>	: <u>Dollars</u>	: <u>Dollars</u>
Land-----	: 10,000	: 10,000	: 21,000	: 11,000
Farm buildings-----	: 6,000	: 3,000	: 3,500	: 500
Residence-----	: 4,000	: 5,000	: 8,500	: [ 3,500 ]
Total-----	: 20,000	: 18,000	: 33,000	: 15,000

<sup>1/</sup> Selling expenses would be prorated in proportion to the values assigned.

<sup>4/</sup> Few guides other than valuation by a competent appraiser are available to determine the market value of a farm dwelling. Sales of comparable property in the community and in nearby towns, or a "replacement cost-less-depreciation" approach are two possible valuation methods.

As land is not depreciable, its adjusted cost basis cannot be less than its cost (except for depletion), but it could be higher if certain types of land improvements had been made. The farm buildings are depreciable, however, and the adjusted cost basis reflects both permanent improvements and allowable depreciation. The dwelling is not a part of the farm business for tax purposes, hence its adjusted cost basis is its cost plus permanent improvements that may have been made. No allowance can be made for depreciation. In this illustration, \$3,500 of the total capital gain of \$15,000 on the property has been allocated to the residence. If another residence costing \$8,500 or more were acquired within the periods specified earlier, the taxable gain would be reduced to \$11,500.

Although market values of farm service buildings have not increased as much as has the price of land in recent years, farm residences have shared in at least a part of the general increase in values of urban residences. This is true particularly in rural areas close to urban centers and those having good transportation facilities. Market forces tend to place values on farmhouses that are comparable to those placed on similar houses in town. Prices paid for entire farms have increasingly reflected such market values for farmhouses.

A person who buys or acquires a farm can largely avoid the subsequent problem of valuing the farm residence if he allocates to the dwelling its share of the cost at the time of purchase. It is easier to make a reasonable estimate then than years later when the property is sold. Keeping accurate records of capital improvements made on the dwelling, as well as on the service buildings, will also help materially to establish the adjusted cost basis.

#### Capital Gains on Condemnation Sales Receive Special Tax Treatment

The expanded Federal highway program, particularly the Interstate system, will require several million acres of land for new rights-of-way and for the widening of existing highways. This will affect thousands of owners of rural land in that a part or all of their individual holdings will be taken under eminent domain. A sale of property under condemnation action, under threat or imminence of such action, or by negotiation with the agency acquiring the right-of-way, receives special tax treatment. In general, if the seller spends an amount at least equal to his proceeds from such a sale to buy other real estate within a certain time period, any gain that may be realized is not subject to tax at that time. The time period in which the replacement property must be acquired begins with the date on which the property owner was first notified that his property would be taken. It ends one year after the close of the first tax year in which any part of the gain is realized. These provisions with respect to gains realized from involuntary conversions of real property are similar to those that apply to tax-free trades and exchanges. In both instances, the recognition of taxable gain is postponed, rather than avoided. If the cost of the replacement property is the same as the payment

received for the converted property, the cost basis of the replacement property is the same as for the property given up. Thus, the full amount of any gain would be subject to tax if the replacement property were later sold. Although special rules apply when the amount spent for replacement property is less, or more, than was realized from the involuntary conversion, they do not alter this general rule.

Many property owners receive severance damages in addition to compensation for the land actually taken for rights-of-way. Such payments compensate the property owner for the loss in market value of the remaining land that results from increased operating expenses or reduction in net income owing to parcelization of his farming unit. That part of the total award received that is identifiable as severance damages is applied to offset costs in the following order: (1) The proportionate share of expenses of obtaining the award for severance damages, (2) special assessments, if any, levied for benefits to the retained property, and (3) expenses of restoring the retained property to its former use. Any balance that remains is used to reduce the basis of the retained property. If the balance exceeds the basis of the retained property, the excess is taxable gain.

Rights-of-way in rural areas usually require only a part of the land owned by an individual. In such instances of partial takings, the nonrecognition of gain applies only to proceeds from the land actually taken, even though the owner may sell the rest and replace it with other land. For example, assume that the owner receives \$5,000 for 15 acres taken from a 160-acre tract with an adjusted cost basis of \$16,000, or \$100 per acre. If the land taken had the same cost basis per acre as the entire tract, the capital gain on the part taken would be \$3,500 (\$5,000 minus \$1,500). Within the time period specified, the owner sells the remaining 145 acres for \$30,000 and buys another farm for \$35,000. His cost basis for the part of the farm sold would be \$14,500 (145 acres times \$100), and the capital gain of \$15,500 (\$30,000 minus \$14,500) would be taxable. However, as he has reinvested the \$5,000 received for the right-of-way, the gain of \$3,500 on this portion would not be taxable, but it would reduce the cost basis of the replacement farm to \$31,500 (\$35,000 minus \$3,500). Thus, the full gain from the right-of-way sale would be taxable if the replacement farm were sold later.

### Alternatives to Open-Market Sale

When a farmer considers retirement, his first thought may be to sell out. Although this may seem to be a logical course, if his potential heirs are not in position to take over the farm, it will pay to give the matter a second thought. If he sells, he not only may be liable for the tax on capital gains but he will limit the opportunities open to him for minimizing the amount of tax that will be payable from his estate.

A farm owner who wishes to dispose of his property during his lifetime should consider several possibilities besides outright sale, especially if he



has heirs who are interested in continuing to farm. The transfer can be made as a gift, either gradually or in a lump sum; it can be partly a gift and partly a sale; or it can take the form of any of a variety of trust arrangements. Choosing the proper method may mean substantial tax savings.

A farmer may wish to give his property to his heirs while he is still living. With proper planning, this can often be done in such a way as to reduce or even eliminate any estate tax to which at his death, the property might otherwise be subject. A gift of property makes neither the donor nor the donee subject to tax on any capital gain that may have accrued to the property, except that the donee may be taxed on any capital gain realized from a subsequent sale.

A possible disadvantage of transferring a farm by gift is that the basis of the property in the hands of the donee cannot be higher than it was in the hands of the donor, increased by any gift tax paid on the transfer. This means that, if there is a capital gain in gift property (that is, if the current value of the property exceeds its adjusted basis in the hands of the donor plus any gift tax paid on the transfer), subsequent sale of the property will subject this gain to taxation. This limitation on the basis of property transferred by gift serves also to limit the amount of depreciation chargeable by the donee on the farm buildings and equipment.

A variant that is sometimes appropriate for a transfer of property to heirs is the combination of gift and sale. The property is sold but at a price below its true market value. For Federal tax purposes, the difference is regarded as a gift. The advantage of this method is the opportunity it offers to utilize fully the gift tax exemption to reduce the amount of the estate that will be subject to tax at the owner's death. A taxable capital gain is realized only if the sale price exceeds the adjusted basis of the property in the seller's hand. In a transfer that is part gift and part sale, the basis of the property to the transferee, for depreciation and capital gain purposes, is the amount paid or the transferor's adjusted basis (increased by the amount of any gift tax paid on the transfer), whichever is greater.

Greater flexibility in transferring property is possible through use of the gift in trust. For example, a farmer and his wife who wish to give up the responsibility of owning and operating the farm, but who feel it necessary to retain claim to the income, may give the farm to their heirs in trust, with the proviso that the income from the property be reserved to them during their lifetime. From a tax viewpoint, however, such an arrangement may be costly. The gift to the trust is subject to the gift tax, if any, at the time of transfer, and also (unless irrevocable) to the Federal estate tax at the grantor's death. However, credit is allowable against the estate tax for gift tax paid with respect to the transfer of property, which is required to be included in the gross estate of the donor.

#### Heirs Acquire New Cost Basis at Time of Owner's Death

Each of the methods discussed so far involves transfer of property while the owner is living - so-called intervivos transfers. Their chief advantage

lies in the opportunities for avoidance of estate and inheritance taxes by reducing the amount of property that passes at the owner's death.

If the estate is too small to be subject to the estate tax (less than \$60,000), the tax advantage often lies in holding property until death. This is the case when the current value of the farm is substantially in excess of the adjusted cost basis, so that a capital gain is involved. The tax law provides that when property passes at the death of the owner, the fair market value of the property at the time of the decedent's death is the basis of the property. 5/

If the heirs retain the farm and continue to operate it, they have the advantage of a higher basis on which to calculate depreciation of buildings and equipment. But if they sell the farm immediately at a price that does not exceed its basis, they will not be taxed on any gain that accrued during the time the farm was owned by the deceased.

Allowing property to pass to one's heirs at death is the only transfer method by which the transferee can acquire a higher basis for the property, without any capital gain being subject to tax, either at the time of transfer or ever. This "step-up" of the basis may be of great significance to farmers who have held their farms for a long time and who may have accumulated large unrealized capital gains. It should be noted, too, that the advantage of this method is not limited to those farmers whose heirs plan to continue to operate the family farm. Even if they do not, there may be a tax advantage to the farmer in retaining the farm during his lifetime, bequeathing the property to his heirs, and allowing them to sell the farm.

A farmer can sometimes save estate taxes by bequeathing his property to a trust, with the income assigned to his children during their lifetime, instead of willing the property to the children directly. He can provide for the ownership of the farm itself to pass to his grandchildren on the death of the children. This method has the advantage of passing property through two generations with only one reduction because of estate taxes. The legal aspects of establishing a trust may be very complex and competent counsel is essential. Nevertheless, it permits a high degree of flexibility in passing property to one's heirs and offers solutions to many complex transfer problems, besides offering opportunities for tax saving.

It is apparent that the tax consequences of all the arrangements discussed here depend on the way in which the property is held. Transfer of a farm held by husband and wife in joint tenancy, for example, differs from transferring one that is in the husband's name alone, and it may result in a greatly differing tax liability. These matters lie beyond the scope of this discussion. But it is important to recognize that the tax aspects of transferring a farm to one's heirs are only one aspect of the larger problem of planning one's estate, which also requires careful attention to such matters as wills, insurance, and tenure of property.

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5/ However, if the property was valued as of a different date for Federal estate tax purposes, the fair market value as of that date is the basis.

Index Numbers of Average Value of Farm Real  
Estate Per Acre, by States, 1912-59

The index numbers of market value of farm real estate published regularly by the Farm Economics Research Division, Agricultural Research Service, have applications in several types of valuation problems. This statement is intended to explain their source, limitations, and applications. The complete index series for each State as of March 1 from 1912 to date is shown in the tables that follow.

The index number for a State expresses the average market value of farm real estate for the given date as a percentage of the average value in the base period. The series published in recent years uses 1947-49 as 100. Average values for all other dates are expressed as a percentage of this average. Thus, an index of 157 means that values are 57 percent higher than in 1947-49. Further, if the index for one date is divided by the index for any other date, a measure of the percentage change in values is obtained. For example, the index for Iowa in 1932 was 55 and for 1959, 157. Dividing the latter number by the former indicates that the average value for the State in 1959 was 285 percent of the value in 1932. Subtracting 100, we find that values have increased 185 percent. Reversing the division shows that the value in 1932 was 35 percent of the value in 1959.

In order to utilize the index numbers properly in specific valuation problems, certain characteristics and limitations of such a statistical measure should be understood. 6/

- (1) The index is based on judgment estimates of market values rather than actual sales. The regular crop reporters (farmers) of the Department send in these estimates regularly along with other facts about crops and livestock in their localities. A special group of farm real estate reporters, which includes dealers and other locally informed people, also provide similar estimates regularly.

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6/ For further details concerning the technical procedures followed in constructing the index, see, "Major Statistical Series of the U. S. Department of Agriculture," Vol. 6, Land Values and Farm Finance, U. S. Dept. Agr. Handb. 118, Oct. 1957.



- (2) Changes in market prices seldom occur uniformly throughout an area as large as a State. The index can reflect only a statistical average that does not necessarily apply to all areas within the State. However, possible differences of this type are less serious over long periods of time than in short periods.
- (3) The index is based on values reported for average land (including buildings) used primarily for agricultural purposes. Land whose value is affected by use or offer for town or suburban lots, industrial or commercial development, timber, mining, oil, and other nonfarm uses is excluded so far as possible.
- (4) Changes in land improvements and quality of farm buildings, general throughout a State, are reflected in the index. In applying the change in the State index to particular properties, an adjustment should be made to allow for any major capital investments, or capital losses that are greater than those prevailing generally throughout the State.

Because of these characteristics and limitations, the index will seldom yield as accurate results in specific valuation problems as can be obtained by following established appraisal procedures. The indexes are not intended as a substitute for on-site inspection and evaluation of the many factors that affect the value of farm properties. As a first approximation, and in instances in which maximum accuracy is not required, the index numbers are a useful tool in many types of situations. Some of the more frequent applications are illustrated in the following examples:

1. A current value is needed for a property having a known value at some earlier date.

$$\frac{\text{Index for current date}}{\text{Index for earlier date}} \times \text{known value} = \text{current value}$$

Example: A property in Iowa purchased in 1932 for \$95 per acre.

$$\frac{(\text{Index for 1959})}{(\text{Index for 1932})} \times \$95 = \$271 \text{ current value}$$

2. The current value of a property is known, and a value is needed for an earlier date.

$$\text{Current Value} \div \frac{(\text{Index for current date})}{(\text{Index for earlier date})} = \text{earlier value}$$

$$\$271 \div \left( \frac{157}{55} \right) = \$95$$

3. A basis is needed to adjust the cash rental rate under a long-term lease to yield a constant ratio of gross rent to value.

Example: A farm valued at \$200 per acre in 1959 is leased for 10 years at \$15 per acre. This is a gross rental rate of 7.5 percent of value (\$15 divided by \$200). Owner and tenant agree that annual rent will be adjusted to yield this return on the market value of the property each year.

$$\text{Rent for 1960: } \frac{\text{State index, 1960}}{\text{State index, 1959}} \frac{165}{157} = 105 \times \$200 = \$210$$

$$\$210 \times .075 = \$15.85 \text{ rent for 1960}$$

$$\text{Rent for 1964: } \frac{\text{State index, 1964}}{\text{State index, 1959}} \frac{148}{157} = 94 \times \$200 = \$188$$

$$\$188 \times .075 = \$14.10 \text{ rent for 1964}$$

4. A basis is needed for setting the future price of a property sold on a revisable-price contract. <sup>7/</sup>

Example: A farm appraised at \$20,000 in 1959 is sold on such a contract. Annual payments are specified, but seller and buyer wish to adjust the final settlement price to reflect the level of market values prevailing at that time. Thus, if prices rise during the term of the contract, seller will receive more than \$20,000; if prices have declined, he will receive less.

$$\frac{\text{Index at settlement date}}{\text{Index at initial contract date}} \times \text{appraised value} = \text{settlement price}$$

5. Assessed values for tax purposes are to be adjusted for the increase in market values since an earlier assessment.

Example: A reassessment in 1956 established an assessment ratio of 40 percent of full market values. How much increase in assessed values is needed in 1959 to restore the same ratio to market values that existed in 1956?

$$\frac{\text{State Index, 1959}}{\text{State Index, 1956}} \frac{157}{136} = 115, \text{ or a 15-percent increase.}$$

Note: This procedure is suggested only for budgeting purposes at the county or State level. Serious inequities could result without a reassessment.

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<sup>7/</sup> For further discussion of contracts of this type, see "Farm Transfers Within Families", Univ. of Ill. Cir. 744, May 1955.

Table 11.- Farm real estate: Index numbers of average value per acre, by States, 1912-59 1/

(1947-49 = 100)

Year	Northeast									
	Maine	New Hampshire	Vermont	Massachusetts	Rhode Island	Connecticut	New York	New Jersey	Pennsylvania	Maryland
1912	72	69	58	64	54	51	68	52	64	62
1913	74	72	58	65	55	52	69	53	65	63
1914	70	73	56	67	54	53	70	54	66	61
1915	69	72	60	64	56	52	69	53	65	62
1916	70	70	66	65	58	53	71	54	68	65
1917	79	74	73	72	61	57	75	59	74	71
1918	82	79	76	79	64	61	77	61	77	77
1919	90	83	78	78	67	63	82	63	80	80
1920	102	91	86	91	71	72	92	69	91	86
1921	95	88	86	88	71	70	85	69	85	80
1922	91	89	83	88	70	73	80	77	80	72
1923	93	79	77	87	68	72	77	61	77	74
1924	91	77	75	86	69	73	77	64	75	66
1925	89	79	72	87	70	72	77	66	74	70
1926	91	80	72	88	71	72	75	71	74	65
1927	89	80	71	86	73	72	74	68	73	62
1928	89	80	71	86	73	73	73	67	72	69
1929	88	79	71	86	73	73	72	67	71	61
1930	89	79	71	86	73	73	71	66	69	61
1931	88	78	70	85	73	73	67	65	66	60
1932	80	72	64	79	69	69	63	63	62	53
1933	68	66	58	74	65	65	56	58	51	50
1934	67	67	57	73	64	64	57	59	51	45
1935	68	64	58	72	64	64	58	59	53	45
1936	68	65	58	72	65	65	59	60	56	47
1937	70	67	58	73	66	66	59	59	57	49
1938	69	66	57	74	66	65	60	61	58	50
1939	67	66	57	74	64	65	59	61	57	50
1940	69	67	58	74	66	65	59	62	58	50
1941	67	68	58	74	66	67	59	65	59	52
1942	69	69	58	74	69	69	61	68	62	55
1943	71	71	63	76	70	70	68	72	67	60
1944	81	76	68	82	76	75	69	74	72	68
1945	85	83	74	87	79	78	75	79	80	73
1946	91	87	83	93	87	86	83	86	85	82
1947	97	97	95	95	95	97	96	97	93	97
1948	99	101	98	101	100	101	98	99	100	99
1949	104	102	106	104	104	102	106	104	107	103
1950	95	97	101	99	101	100	105	103	102	99
1951	98	101	106	107	109	107	110	108	117	106
1952	103	105	113	112	111	110	121	122	129	121
1953	111	108	113	112	111	111	121	126	129	129
1954	109	105	107	106	109	109	117	129	130	129
1955	104	105	104	106	108	111	119	132	134	136
1956	107	108	107	108	112	115	124	143	143	140
1957	114	113	112	117	122	126	133	156	154	148
1958	118	119	120	126	133	138	137	168	163	167
1959	125	129	129	137	145	149	146	183	172	179

1/ All farmland with improvements, as of March 1



Table 11.- Farm real estate: Index numbers of average value per acre, by States, 1912-59 1/  
(1947-49 = 100)

Year	Lake States				Corn Belt				Northern Plains			
	Michigan	Wisconsin	Minnesota	Ohio	Indiana	Illinois	Iowa	Missouri	North Dakota	South Dakota	Nebraska	Kansas
1912-----	49	68	61	59	57	65	66	82	90	110	78	64
1913-----	50	69	64	60	59	67	68	85	93	116	80	63
1914-----	52	71	68	61	61	69	71	88	96	118	82	63
1915-----	53	72	69	64	60	68	77	87	96	116	81	65
1916-----	56	82	78	68	65	70	87	92	104	124	83	69
1917-----	61	86	89	72	69	74	91	98	110	133	89	72
1918-----	68	93	100	79	76	79	99	107	116	145	102	77
1919-----	69	99	108	81	80	87	110	117	121	166	116	83
1920-----	78	119	138	95	96	106	146	142	135	207	144	95
1921-----	77	117	136	81	88	102	134	133	131	199	133	94
1922-----	75	107	121	75	71	84	111	114	127	168	116	82
1923-----	73	102	114	73	68	82	106	109	119	145	111	80
1924-----	70	97	109	71	64	77	98	99	106	135	103	74
1925-----	67	90	103	66	60	77	93	95	102	132	99	72
1926-----	65	87	100	63	57	73	89	88	98	123	98	71
1927-----	64	85	94	60	52	66	82	84	93	112	95	71
1928-----	63	83	90	57	50	64	80	82	92	110	94	71
1929-----	63	82	89	57	49	63	79	81	91	109	93	71
1930-----	61	81	86	54	47	61	77	78	89	107	90	71
1931-----	58	72	75	49	43	54	67	68	79	95	85	65
1932-----	49	63	63	42	35	44	55	57	68	76	72	56
1933-----	41	56	51	35	33	36	40	47	61	63	56	44
1934-----	42	56	53	38	33	39	43	49	63	63	58	45
1935-----	42	57	53	40	36	41	46	49	62	63	58	46
1936-----	43	59	55	43	39	43	50	51	64	63	59	47
1937-----	46	62	56	45	42	47	50	52	62	63	58	49
1938-----	46	61	56	44	43	49	51	51	59	59	55	49
1939-----	46	59	55	46	43	48	50	49	53	51	52	48
1940-----	46	58	55	46	44	50	50	50	48	47	47	45
1941-----	47	57	56	48	46	51	51	51	48	46	44	45
1942-----	53	61	58	53	52	57	54	56	51	48	47	47
1943-----	58	64	64	59	58	61	60	63	54	53	51	53
1944-----	58	71	71	67	67	70	69	70	65	65	62	61
1945-----	73	76	74	72	73	74	73	78	71	69	68	70
1946-----	85	83	83	84	86	83	82	87	78	76	77	76
1947-----	98	94	92	95	94	94	92	96	86	86	87	89
1948-----	100	101	102	100	102	100	103	99	104	103	101	104
1949-----	102	105	106	105	104	105	106	105	110	111	112	108
1950-----	100	101	109	101	103	108	108	106	107	111	104	106
1951-----	115	112	127	120	123	127	125	123	116	127	124	119
1952-----	123	119	137	134	135	138	132	138	133	145	136	131
1953-----	126	119	134	134	138	140	128	132	136	140	136	133
1954-----	128	113	127	132	137	139	125	123	135	135	127	125
1955-----	133	113	135	141	147	142	133	130	132	139	134	129
1956-----	141	117	145	151	154	149	136	134	136	140	133	133
1957-----	152	127	160	161	166	161	142	146	150	146	131	136
1958-----	158	133	171	171	173	169	147	156	162	156	146	147
1959-----	170	142	181	178	182	182	157	169	178	171	159	156

1/ All farmland with improvements, as of March 1

Table 11.- Farm real estate: Index numbers of average value per acre, by States, 1912-59 <sup>1/</sup>  
(1947-49 = 100)

Year	Appalachian Region					Southeast					Delta States				
	Virginia	West Virginia	North Carolina	Kentucky	Tennessee	South Carolina	Georgia	Florida	Alabama	Mississippi	Arkansas	Louisiana			
1912-----	42	66	30	36	37	48	54	41	38	42	42	47			
1913-----	43	68	31	37	39	47	55	42	38	44	43	48			
1914-----	44	70	32	38	40	48	55	45	40	44	43	47			
1915-----	42	69	32	37	39	45	51	42	38	42	40	45			
1916-----	50	70	36	41	47	47	57	44	38	46	46	50			
1917-----	54	76	40	47	47	51	64	47	40	52	55	53			
1918-----	61	83	47	55	56	59	72	54	50	57	63	68			
1919-----	72	92	55	64	65	78	94	61	56	67	72	74			
1920-----	81	105	69	75	78	110	119	76	69	94	94	94			
1921-----	77	96	61	64	66	89	94	75	57	65	79	77			
1922-----	68	85	52	56	60	60	75	67	52	64	74	66			
1923-----	73	87	60	55	62	62	68	67	56	62	72	68			
1924-----	70	85	59	53	57	65	67	70	56	58	68	65			
1925-----	67	81	58	52	53	66	63	74	60	59	68	67			
1926-----	64	79	57	52	52	61	61	96	60	58	65	68			
1927-----	59	75	55	50	50	54	57	78	56	55	64	64			
1928-----	59	74	53	48	49	53	56	75	56	53	62	62			
1929-----	58	73	51	48	48	53	56	74	56	53	62	62			
1930-----	58	71	49	48	48	50	55	74	56	53	60	62			
1931-----	50	67	42	43	44	43	49	71	50	49	50	57			
1932-----	43	55	35	36	37	35	38	60	40	40	44	49			
1933-----	38	50	27	30	31	27	31	52	34	31	34	42			
1934-----	39	53	31	30	33	32	35	54	39	35	36	46			
1935-----	42	53	35	33	35	37	39	54	43	39	37	49			
1936-----	44	56	38	33	38	37	40	55	44	40	39	49			
1937-----	48	56	41	37	39	40	43	57	45	42	39	51			
1938-----	48	57	43	39	40	42	43	57	48	46	41	56			
1939-----	48	58	43	40	40	42	44	56	48	46	40	55			
1940-----	48	58	43	42	42	43	45	57	47	46	40	57			
1941-----	49	61	42	43	44	46	48	58	49	48	42	58			
1942-----	51	62	47	48	48	49	51	64	50	53	47	60			
1943-----	56	67	50	55	54	54	56	72	54	57	52	68			
1944-----	63	72	60	61	62	65	66	81	62	63	60	72			
1945-----	74	72	70	70	69	78	73	96	69	71	71	77			
1946-----	86	83	82	82	82	82	80	115	80	84	76	83			
1947-----	97	93	95	98	94	93	95	109	96	92	90	96			
1948-----	97	101	99	98	100	100	98	97	97	102	100	95			
1949-----	106	105	105	105	105	107	107	94	107	106	110	109			
1950-----	101	95	106	102	103	97	99	97	101	106	105	105			
1951-----	115	105	117	116	115	108	109	109	113	122	120	111			
1952-----	129	112	132	128	124	117	128	120	125	134	131	120			
1953-----	134	113	138	123	125	119	136	123	131	139	128	130			
1954-----	129	107	133	116	116	120	134	134	125	135	124	132			
1955-----	135	110	140	135	115	121	138	141	125	137	126	138			
1956-----	143	117	146	115	121	126	145	157	134	147	132	146			
1957-----	152	125	154	127	129	136	157	183	142	159	144	161			
1958-----	161	142	161	133	136	143	171	213	152	169	152	174			
1959-----	174	142	170	145	150	155	188	245	169	186	163	192			

<sup>1/</sup> All farmland with improvements, as of March 1

Table 11.- Farm real estate: Index numbers of average value per acre, by States, 1912-59 <sup>1/</sup>  
(1947-49 = 100)

Year	Southern Plains					Mountain Region					Pacific Region				
	Okla- homa	Texas	Montana	Idaho	Wyoming	Colorado	New Mexico	Arizona	Utah	Nevada	Wash- ington	Oregon	Cali- fornia		
1912-----	52	53	76	46	53	64	46	43	60	72	47	55	40		
1913-----	54	55	79	47	56	67	48	45	61	75	48	57	42		
1914-----	54	58	81	46	55	64	44	47	58	77	49	58	46		
1915-----	50	57	79	45	56	60	46	44	58	76	48	56	47		
1916-----	56	57	74	46	51	66	46	43	62	74	49	57	49		
1917-----	61	69	79	53	53	71	51	47	70	51	54	59	72		
1918-----	70	74	83	61	66	71	54	56	73	77	57	63	58		
1919-----	75	78	90	68	80	76	58	63	86	87	58	67	60		
1920-----	89	97	99	80	97	91	66	74	100	101	67	73	71		
1921-----	86	86	83	75	80	85	57	74	82	92	64	74	72		
1922-----	74	73	75	63	73	79	53	61	80	89	59	69	71		
1923-----	71	71	68	62	66	73	51	56	80	83	56	65	70		
1924-----	67	76	64	60	61	63	51	54	78	81	55	64	81		
1925-----	70	81	59	57	54	60	50	55	78	77	54	62	70		
1926-----	69	81	57	55	52	57	49	57	77	74	54	61	69		
1927-----	68	78	59	58	52	58	49	57	78	75	55	63	71		
1928-----	68	77	64	61	56	58	49	63	79	74	55	63	70		
1929-----	68	76	66	61	59	58	50	62	79	74	52	63	70		
1930-----	68	76	64	60	61	57	52	63	75	74	54	63	70		
1931-----	62	68	57	53	57	53	48	58	65	68	47	56	64		
1932-----	50	53	45	44	44	40	38	45	57	58	39	53	53		
1933-----	41	46	37	34	33	32	32	34	47	46	32	35	40		
1934-----	44	49	38	35	33	32	33	34	47	45	35	34	39		
1935-----	46	51	39	37	33	32	34	37	47	45	38	35	41		
1936-----	49	52	41	39	36	34	34	40	44	49	40	44	48		
1937-----	48	53	43	43	38	36	35	43	49	49	45	41	48		
1938-----	50	55	42	42	39	37	35	41	48	49	45	41	48		
1939-----	50	54	42	42	39	37	35	41	48	49	45	41	43		
1940-----	50	55	43	43	40	37	36	40	49	49	45	41	42		
1941-----	51	54	45	44	42	38	38	45	52	50	46	44	42		
1942-----	54	58	49	48	46	42	42	48	56	54	52	48	47		
1943-----	59	61	55	55	53	47	49	57	60	61	57	54	55		
1944-----	64	69	62	66	61	57	62	67	67	71	70	65	67		
1945-----	69	77	68	76	67	64	70	75	73	81	75	74	80		
1946-----	82	84	79	84	81	77	82	87	83	92	88	88	94		
1947-----	90	92	93	93	91	92	89	97	94	99	95	97	102		
1948-----	98	104	101	102	105	102	103	101	102	102	103	103	101		
1949-----	112	104	107	105	104	107	108	102	104	99	102	101	97		
1950-----	108	102	104	107	100	104	107	99	107	99	101	99	94		
1951-----	127	121	127	125	118	121	123	113	121	114	117	114	108		
1952-----	138	139	141	134	129	133	138	127	134	129	127	121	123		
1953-----	133	134	144	138	128	130	136	136	137	129	134	127	125		
1954-----	128	133	142	136	123	128	135	135	133	137	132	123	122		
1955-----	136	137	146	142	123	128	136	137	137	139	137	128	128		
1956-----	138	139	152	146	123	124	137	144	134	142	140	130	137		
1957-----	148	151	162	151	121	121	133	145	145	145	147	137	147		
1958-----	155	158	171	158	128	130	141	157	142	153	156	144	158		
1959-----	168	169	183	169	138	138	149	168	150	164	167	152	172		

<sup>1/</sup> All farmland with improvements, as of March 1.





